

# AUDIT MANUAL

## Chapter 6

### *Motor Vehicle Dealers*

#### *Sales and Use Tax*



DEPARTMENT OF BUSINESS TAXES

*State Board of Equalization*



# CHAPTER 6

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# CHAPTER 6

## MOTOR VEHICLE DEALERS

**0600.00**

### INTRODUCTION

**0601.00**

#### GENERAL

**0601.05**

A motor vehicle may be defined as an automobile or a truck. The material included herein, however, applies to audits of the records of any seller whose transactions are similar to those of a motor vehicle dealer. This is particularly true of dealers in house trailers, motorcycles and tractors.

#### CLASSES OF DEALERS

**0601.10**

Motor vehicle dealers may be divided into the following classes:

- |                     |                       |
|---------------------|-----------------------|
| a) Distributors     | e) Used Car Dealers   |
| b) Assembly Plants  | f) Wholesale Only     |
| c) Factory Branches | g) Automobile Brokers |
| d) New Car Dealers  |                       |

Distributors occasionally are also new car dealers, and new car dealer usually sell used cars.

#### DISTRIBUTORS

**0601.15**

There are two types of distributors with which auditors usually come in contact:

- Several automobile manufacturers maintain zone or regional offices for each of their divisions within California. The functions of these offices include distribution of new automobiles to franchised dealers.
- Separate entities also are granted exclusive rights of distribution by the manufacturer. This type of distributor sometimes serves as a new car dealer.

Also, there are other types of distributorships or variations to those described above.

#### ASSEMBLY PLANTS

**0601.20**

Certain of the larger manufacturers have established assembly plants at points within California in order to better serve their distributors. Such assembly plants seldom function as distributors, but rather take the place of the factory as a source of supply of certain models. Assemblers are not licensed by the Department of Motor Vehicles, and tax is reported by the dealer who reports the sale to the Department of Motor Vehicles (See Section **0605.30**)

#### FACTORY BRANCHES

**0601.25**

Certain manufacturing divisions have factory branches which operate as new car dealers securing their new automobiles through the zone office or function both as new car dealers and distributors.

#### RECORDS OF DISTRIBUTORS

**0601.30**

It is usually necessary for a distributor to maintain records of a type which are adequate for sales tax auditing purposes, since factory requirements and relationships with dealers are usually sufficiently exacting to require such records.

#### DEALERS — NEW CARS

**0601.35**

The records which a new car dealer keeps are very often specified, and sometimes supplied by the distributor or manufacturer. Several adequate systems for dealer usage have been evolved by the manufacturers and are in wide use.

#### DEALERS — USED CARS

**0601.40**

The books and records of dealers handling used cars exclusively are not usually as extensive or detailed as those of new car dealers or distributors since, unlike the foregoing, they are under no compulsion to maintain a certain type of records.

## DEALERS — WHOLESALE ONLY

0601.42

A new class of “Wholesale Only” dealer’s license was authorized as of January 1, 1982. Such licensees are limited to use of DMV wholesale Report of Sale books only and are not authorized to sell vehicles to other than licensed dealers or to use retail Report of Sale books.

## BROKERS

0601.45

An automobile broker may be defined as one who procures new, and occasionally used automobiles from regular franchised new car dealers and licensed used car dealers. Their operations vary depending on their relationship with their clients. They may act as an agent for either the buyer or the seller, or they may act as an independent agent.

*Where the car dealer bills the broker’s client for the automobile, with the broker acting as agent of the buyer, the tax will apply to the amount billed by the dealer. The fee charged by the broker is not subject to tax.*

*Where the car dealer bills the customer for the automobile, with the broker acting as agent of the selling dealer, the tax will apply to the amount billed by the dealer. No deduction can be taken by the dealer for commissions paid to the broker.*

Some brokers have sellers’ permits and/or used car dealer’ licenses since they accept trade-in, and may maintain a used car lot.

There are no guidelines which will enable the auditor to determine in which capacity the broker is acting in every situation. Each transaction must stand on its own merits. Generally speaking, however, the broker will receive a commission from his or her principal and may or may not be empowered to act for the principal in signing car orders and other documents pertaining to the transaction.

## BROKERS ACTING AS INDEPENDENT RETAILERS

0601.50

- a) Where the broker agrees in advance to secure an automobile for a client at a specified price, the broker is the retailer. It is immaterial that the car dealer bills the broker or the broker’s client.
- b) Where the car dealer bills the broker for the automobile and the broker in turn bills the client, the broker is the retailer.

Brokers who are licensed with the Department of Motor Vehicles, and who utilize a “Dealer’s Report of Sale” must hold a seller’s permit and pay sales tax on sales of vehicles, which they arrange between private parties, and as to which they file a “Dealer’s Report of Sale.” Sales to the broker by a “dealer” of vehicles which will be subsequently resold by the broker are sales for resale and appropriate documentation should be retained by the dealer to support their exempt status.

Brokers who intend to bill their clients for the vehicle should advise the dealer from whom they purchase it of the amount of sales tax to be charged. If the amount of tax charged by the dealer is sufficient to cover the broker’s selling price to his or her customer, there is no additional liability to the broker. However, leads on the dealer charging the sales tax should be prepared, as it sometimes occurs that the dealer’s invoice does not reflect this charge. An example follows:

	Invoice in Broker’s File From Dealer	Invoice in Dealer’s file to Broker
Automobile	\$12,000	\$12,113
Sales Tax on \$14,000	840	727
	\$12,840	\$12,840

The tax due from the dealer in this case is \$840. When auditing dealers who sell to brokers, auditors should check for evidence of tax on an amount greater than the selling price reflected in the dealer’s records.



## **DEALER'S RECORDS PREPARED BY DATA PROCESSING SERVICE BUREAUS**

**0601.52**

### **GENERAL**

There are several electronic data processing service bureaus specializing in preparing books and records for new car dealers. In the typical system, dealership personnel prepare the invoices and other source documents. The information from the source documents is then transcribed into a machine readable media such as punched paper tape which is sent periodically to the service bureau. The service bureau uses its computer to sort and summarize the data and electronically print the dealer's journals, ledgers, and other reports.

The auditor may find the electronically produced records more difficult to audit than manually prepared records because:

- a) Numeric codes are used extensively in place of alphabetic customer names and account titles.
- b) The general ledger is prepared on a monthly basis rather than an annual basis.
- c) Entries in journals are printed vertically rather than in the traditional horizontal spreadsheet format.
- d) The auditor cannot readily determine the adequacy or accuracy of the electronic system. Thus, his tests may be more extensive than necessary.

### ***THE REYNOLDS & REYNOLDS COMPANY SYSTEM***

This system is used extensively by dealers in domestic new cars. Audit time can be saved by understanding the procedures used and records available in this and similar systems.

### ***SOURCE DOCUMENTS***

Invoice forms, repair order forms, etc., are furnished to the dealer by Reynolds & Reynolds Company. They are the typical dealership forms and contain an account block area for account posting information.

### ***ENCODING FROM SOURCE DOCUMENTS***

Using a special adding machine provided by Reynolds & Reynolds Company, car dealer personnel transcribe account numbers and monetary amounts from source documents onto an optical font paper tape. The special characters on the tape can be interpreted electronically by an optical scanner at the Reynolds & Reynolds data center. The adding machine device incorporates several control features to prevent out of balance entries and other errors.

### ***PROCESSING OF DATA***

The optical font tapes are edited at the data center and converted to magnetic tape. Standardized ("canned") computer programs are used to produce the monthly printed journals, ledgers, and reports from the data on magnetic tape. The data center retains the optical tapes received, but send all copies of journals, ledgers and reports to the dealer. The dealer retains a copy of each tape, also. The tapes are in numerical sequence, by months, and the tape number is identified in the journals.

### ***JOURNALS***

All typical dealership journals are provided. The detail of each transaction is listed vertically in account number sequence within document number sequence. The last page of each journal summarizes the entries to each account. These summary figures can be traced directly into the general ledger. Control numbers, which can be car deal numbers, customer numbers, stock numbers, etc., depending on the journal, are also listed. Only numeric codes are printed; there are no customer or vendor names printed in the journals.

### ***GENERAL LEDGER***

A separate general ledger is printed for each month of the year. In addition, an annual general ledger is printed at the end of the accounting year, listing all entries during the year. The ledger is of typical format and entries are readily traceable to the journals.

## MANAGEMENT SCHEDULES

Certain reports called "Management Schedules" are provided to the dealership by Reynolds & Reynolds. They are bound separately from the journals and general ledger and may not be readily available in the dealership's accounting department. Audits of this system have been made without knowledge of the existence of the management schedules. This has resulted in some wasted audit time and effort. Unlike the journals, some schedules do contain vendee and vendor names. The significant management schedules are:

- a) **Car Deals** — This schedule lists all car "deals" begun or completed during the month and includes the customers' names. Each sale in the new and used car journals can be traced to the "car deals" schedule in order to match the sale to the purchaser's name.
- b) **New and Used Car Inventories** — These schedules list all cars in inventory during the month including cars added or deleted due to purchases and sales. The cars appear in stock number sequence. These schedules can be useful in identifying sales not recorded in the sales journals or vehicles which have remained in inventory for long periods (house cars and demonstrators).
- c) **Sublet Repair Inventory** — This schedule is a summary of charges and credits to the sublet account. Sublet repairs which were billed to customers can be isolated from internal sublet repairs. This schedule may assist in the test of sublet repair material recorded as exempt labor.
- d) **Accounts Payable** — This schedule is an inventory of accounts payable and a record of the debits and credits to the account during the month. It contains vendors' names and therefore may be of use in conjunction with the examination of the purchase journal.
- e) **Invalid Accounts** — This schedule identifies the source of entries made to accounts which are invalid (not found in the dealer's chart of accounts). The invalid entries are held in suspense until the dealer makes a correction through the following month's general journal. It should be noted, however, that entries made to incorrect but valid accounts will be processed normally and will not appear in the invalid accounts schedule.

## AUDIT PROCEDURE

An initial step in an audit where the Reynolds & Reynolds system is employed should be to review the management schedules as potential sources of information. The circumstances will determine their use in the audit. For example, if no numeric file of car sales invoices is maintained, it may be necessary to identify customer names by using the "Car Deals" schedule in conjunction with the car sales journals. Another use of the management schedules might be to examine the car inventory schedules to identify company cars and demonstrators where the dealer has failed to set up a separate general ledger account for them.

Electronic data processing service bureaus provide a basic package of accounting records to the dealer. These basic records are produced using standardized or "canned" programs. Thus, the basic package of records produced for one dealer will be the same as those prepared by the service bureau for another dealer. However, the service bureau may also offer optional services at extra cost. During the initial survey of a dealer's system, the auditor should attempt to determine if useful records are being provided as optional services.

When the auditor encounters difficulty in tracing summary figures to source documents or in isolating certain types of transactions for examination, the dealer's assistance should be solicited. Dealer personnel often trace or isolate data in the day-to-day operation of the business and may have developed timesaving techniques which can expedite the auditor's verification.

## **SALES RECORDS**

**0602.00**

### **GENERAL**

**0602.05**

The sales records of motor vehicle dealers who maintain adequate accounting systems are usually similar to those described in Sections **0602.10** to **0602.30**.

### **SALES DOCUMENTS**

**0602.10**

There are three types of billings used by most automobile dealers namely:

- a) Car invoices and/or orders.
- b) Parts and accessory counter sales invoices.
- c) Repair order.

### **CAR INVOICES AND CAR ORDERS**

**0602.15**

Most dealers use a car order as the basic document of sale, and prepare the sales invoice from the car order. Those dealers who do not furnish an invoice to the customer provide instead a copy of the car order. Car invoices normally are renumbered and are prepared in triplicate: One copy is filed in the customer deal folder; one copy is filed in a binder in numerical sequence and one copy is for the customer if it is the dealer's practice to furnish an invoice.

### **SALES JOURNALS**

**0602.20**

The journals normally used by new car dealers are:

- a) New Car Retail.
- b) New Car Fleet.
- c) New Car Commercial.
- d) Used Car.
- e) Parts, Accessory, and Service.
- f) Internal.

### **FINANCIAL STATEMENTS**

**0602.25**

Most new car dealers will have adequate records, particularly where accounting systems prescribed by major automobile manufacturers are used.

Included in the records are monthly financial statements prepared on forms furnished by the manufacturer or distributor which will reflect the dealer's operations in considerable detail. They will include all the sales posted to the general ledger sales accounts from the various sales journals as described in Section **0602.20** as well as those sales posted from the general or standard journals.

### **DEALER'S SALES TAX WORKING PAPERS**

**0602.30**

The majority of dealers prepare and retain working papers in support of each sales tax return. The format and amount of detail vary. In all audits it is necessary that the auditor examine this data thoroughly to establish method of reporting, sources of amounts, and consistency of reporting procedures.

## **AUDIT PROCEDURE IN GENERAL**

**0603.00**

### **INTRODUCTION**

**0603.05**

In general, an audit of a motor vehicle dealer follows the same pattern as an audit of any other seller. It should be noted that new car dealers' operations are departmentalized, with records which reflect specialization.

### **USE OF FINANCIAL STATEMENTS**

**0603.10**

Sales per the financial statements (Section **0602.25**) should be traced to the sales tax working papers. An acceptable practice is to transcribe annual totals as the base amount for comparison with reported sales for the particular year. Only under unusual circumstances would an auditor disregard financial statement totals and transcribe sales from the general ledger.

The auditor should bear in mind that sales per financial statements do not necessarily include all sales, nor do they reflect the proper amounts of all allowable deductions.

It should be noted that total sales per financial statements ordinarily are net of discounts and overallowances. (See Sections **0604.55** and **0604.60**)

### **USE OF DEALER'S SALES TAX WORKING PAPERS**

**0603.15**

The dealer's supporting schedules can be an important factor in determining audit procedures and the extent of examination and tests. It is recommended that the first step in the audit be a detailed examination of the dealer's working papers and returns for the audit period. These schedules can provide the base amounts of audited sales and deductions and save valuable audit time. Verification of recorded detail may be made directly to the dealer's working papers avoiding unnecessary scheduling.

### **EXAMINATION OF GENERAL LEDGER**

**0603.20**

General ledger accounts must be examined to determine postings of sales to proper accounts, and also the posting of all accounts in conformance with acceptable accounting procedures.

Analysis of the ledger accounts together with the comprehensive examination of sales tax working papers will help the auditor formulate an audit program.

### **SALES TAX ACCRUAL ACCOUNT**

**0603.25**

An analysis of the sales tax accrual account should be made as it may disclose leads to unreported sales or to excessive deductions. A sales tax accrual account showing credits only slightly in excess of taxes paid, or payments in excess of collections, does not necessarily indicate errors in reporting.

In reconciling the accrual account, the auditor should adjust for tax on the measure of bad debts claimed, refunds of tax to customers who were charged in error, and for any other instances where taxpayer did not debit accrual account where such a charge was in order. Auditor should also adjust for such items as reported self-consumed merchandise, rental receipts on demonstrators and any other sales reported on which taxpayer did not accrue tax.

If, after making the above adjustments, an excess debit or credit of tax still exists, tests should be made of the various journals comparing the accrual with recorded taxable sales from the respective journal.

For periods prior to January 1, 1979, an excess of tax from the car sales journals may indicate excess tax reimbursement resulting from tax charges to the nearest or next higher whole dollar, unallowable discounts, overallowances, or netted trade-ins.

The measure of sales tax accruals from cash receipts, and general journal entries should be traced to taxable measure reported.

For periods on and after January 1, 1979, if a retailer adds to the sales price of tangible personal property sold at retail an amount represented to the customer as sales tax reimbursement in excess of the amount computed in accordance with Civil Code Section 1656.1 and does not return the amount to the customer, the amount will be regarded as part of the price of the property sold. The retailer will be regarded as having sold the property for a price which includes sales tax reimbursement. See Regulation 1700 (a)(4).

## **REGULAR SALES OF NEW AND USED CARS**

**0604.00**

### **GENERAL**

**0604.05**

As indicated (Section **0603.10**), certain adjustments to recorded sales figures usually will be required in establishing audited total sales. Sections **0604.10** to **0604.25** provide information relative to Department of Motor Vehicles requirements and use of DMV Reports of Sale. The remaining sections cover many items encountered most frequently and provide background information.

### **VEHICLE CODE**

**0604.10**

Three of the provisions of the Vehicle Code of the State of California which are important from the standpoint of the auditor are:

- a) Requirements for the registration of vehicles.
- b) Conditions under which dealers must report sales to the Department of Motor Vehicles.
- c) Conditions under which lessor-retailers are required to pay sales tax on retail sales of vehicles.

Section 4000 of the Vehicle Code defines vehicles subject to registration with the Department of Motor Vehicles and includes:

“... motor vehicle, trailer, semi-trailer, pole or pipe dolly, logging dolly, or auxiliary dolly...”

This includes all types of automobiles, buses, motor cycles, trucks, and trailers. Section 5901 of the Vehicle Code requires that dealers or lessor-retailers in both new and used cars report all retail sales to the Department of Motor Vehicles. It reads as follows:

“Every dealer or lessor-retailer, upon transferring by sale, lease or otherwise any vehicle, whether new or used, of a type subject to registration under this code, shall, not later than the end of the fifth calendar day thereafter, not counting the day of sale, give written notice of the transfer to the department at its headquarters upon an appropriate form provided by it.”

Effective January 1, 1977, Section 11615.5 of the Vehicle Code requires a licensed lessor-retailer to pay sales tax with respect to the retail sale of a motor vehicle, except a sale to the lessee of the vehicle, if the lessor-retailer files a report of sale with the Department of Motor Vehicles.

### **DEALER'S REPORTS OF SALE**

**0604.15**

The Vehicle Code requires that dealers apply for a dealer's certificate of registration and report all sales on appropriate forms, one copy of which is retained by the dealer, and one copy filed in the headquarters office of the Department at Sacramento. These reports contain such information as the dealer's name, address, and registration certificate number, the purchaser's name and address, the make of vehicle sold, the date of sale, and engine number/serial number, body type and model name and number. The Department's copies of these reports of sale are retained for the current year and two prior years.

### **NEW CAR SALES**

**0604.20**

In the code of new vehicles, the report form used is “Dealer's Report of Sale and Application for Registration”. Since this form of report also serves as the application for registration, it is virtually impossible for a purchaser to secure registration of a new automobile unless he has signed the dealer's report of sale and unless the dealer has sent that form to the Department of Motor Vehicles. For this reason, there should be a report of sale on file in the Department of Motor Vehicles for every new car sold. However, some new car dealers do not comply with the Vehicle Code in that they do not submit a report of sale on a unit sold to an out-of-state resident when the vehicle is not to be registered in California.

### **USED CAR SALES**

**0604.25**

In the case of used vehicles, the report form used is “Dealer's Report of Sale and Transfer”. While the Vehicle Code requires the dealer to file such a report for each sale, it is possible to transfer registration into the name of the purchaser without submission of the report. Occasionally, dealers have sought to conceal their connection with the sale of used cars by failing to file a “Dealer's Report of Sale and Transfer” and by not inserting their names as required on the reverse side of the Certificate of Ownership (pink slip). Such pink slip transfers indicate passage of title directly from one owner to another. The auditor cannot, therefore, be sure that the records of the Department of Motor Vehicles disclose all sales of used cars by dealers.

*October 1985*

## DEALER'S REPORT OF SALE AS EVIDENCE

0604.30

The filing of a Dealer's Report of Sale will be presumptive evidence that the dealer who filed the report made the sale. However, there may be cases where this presumption can be overcome as, for example:

- a) Where a dealer improperly acquires the report book of another dealer and fills in the name of the dealer to whom the book was issued.
- b) Where a dealer sells a car to another dealer and the registration is in the name of the purchasing dealer.
- c) Where a dealer rents a vehicle to a salesman and reports the vehicle as sold in order that it may be registered in the salesman's name. (See Section (b) & (c) of Regulation 1669, Demo. & Display.)
- d) Where a dealer registers a vehicle in the name of the manufacturer. ([Section 0605.30](#))

## USE OF DEALER'S REPORTS OF SALE IN AUDITING GROSS RECEIPTS 0604.35

It is apparent from the preceding sections that an examination of some or all of the dealer's copies of reports of sale can be of great value in auditing a dealer's records. In the examination, notations of self-registrations, sales to leasing companies, sales to out-of-state residents, and registrations to other dealers should be made for reference in auditing self-consumed merchandise and deductions.

The auditor should verify that all dealer's report of sale books are available and have been accounted for in the taxpayer's records. As a routine procedure prior to beginning all used car dealer audits, a member of the district office staff must call DMV's Occupational Licensing Unit in Sacramento and obtain the serial numbers, year of issue, and total number of DMV Report of Sale Books issued to the dealer to assist the auditor in verifying whether all the dealer's report of sale books are available. The telephone numbers for this DMV Sacramento office are:

### Dealer License No.

#### Ending In

#### Lease Line Phone No (Outside Sacramento Area)

#### Off Network Phone No. (Within 40 Miles of Sacramento)

0, 1, or if  
number unknown

8-497-7637

(916) 732-7637

2, 3, 4, or 5

8-497-7746

(916) 732-7746

6, 7, 8, or 9

8-497-7556

(916) 732-7556

This information must be entered on the reverse side of the Form BT-414 for use during the audit.

In new car dealer audits, the information should be obtained from DMV only when poor records, loose internal control or other special circumstances warrant.

Occasionally, dealer's report of sale books may not be available and must be obtained from the Department of Motor Vehicles by the auditor, because DMV has secured them for audit or the dealer has ceased operations.

## EXAMINATION OF SALES JOURNAL

0604.40

- a) **NEW CAR RETAIL.** The standard journals prescribed by the manufacturers are usually printed with account titles and account numbers. They are self-explanatory following examination of the general ledger accounts. The general composition should be examined with particular attention to postings to the general ledger columns, credit postings to expense accounts for a portion of the new car selling price, and debit (red figure) entries to sales accounts.
- b) **NEW CAR FLEET.** Postings are also from new car invoices, but the sales are to leasing companies and purchasers who buy in quantity at a special discount. The considerations are the same as for "New Car Retail."
- c) **NEW COMMERCIAL.** Postings are from new car invoices in the same numbered series as passenger cars, or from a separate series of invoices devoted solely to commercial vehicles. In addition to the considerations noted in the foregoing paragraphs, special attention must be given to the manner of handling special bodies. Often, the special bodies are by separate contract and the systems for controlling such sales vary.



- d) **USED CARS.** The sales contained in this journal cover used cars — retail, used cars — wholesale, used trucks — retail, used trucks — wholesale and sales of repossessions. Postings are based on used car invoices. Again, aside from general composition of the journal, particular attention should be paid to general ledger column postings and debits to sales accounts. In addition, the auditor should be alert for discount accounts and combination of both wholesale and retail sales in the single column of repossessions. In scanning the sales columns, the auditor should take note of the margins of profit on used car — retail sales, since abnormally high margins are indications of deflating trade-ins.
- e) **PARTS, ACCESSORIES AND SERVICE JOURNAL.** This journal is a summary of repair order and counter sales invoices as recorded in the daily sales summary. It must be scanned for the combining of taxable and non-taxable sales in posting. Some dealers add small charges to repair orders for supplies used and credit this amount to expense accounts rather than to a taxable sales account.
- f) **INTERNAL.** The composition of the journal has the characteristics of both the service and parts journal, and postings to this book of original entry are from internal repair orders and sales invoices. This journal is peculiar to automobile accounting. Its purpose is to allocate expenses and establish cost control. Sales to consumers should never be entered in this record. Indications of self-consumption are noted in this record by examination of debits to company car and demonstrator expense accounts.

## **CAR INVOICE DATA**

## **0604.45**

This section is concerned only with car invoices. Invoices on repair orders are discussed under labor in Sections **0611.10** to **0611.45**. Invoices on parts and accessories are discussed in Section **0607.30**. The extent of examination of car invoices is determined by the volume of sales, number of invoices, and indications of discrepancies from sales tax working papers, sales tax accrual account, or other sources.

Copies of invoices filed in numerical sequence in a binder are used as the posting copy to the car sales journals. Often the posting data are placed on the reverse side of the invoice since the face of the invoice contains lumped amounts and gives no indication of account numbers.

Examination of the face of the invoice should be made for content, and comparison of content with posting data.

The numerical sequencing should be noted and compared with the sequence in sales journals. Particular attention must be paid to voided invoices and the use of the invoices as credit memos.

## **EXAMINATION OF CUSTOMER FOLDERS**

## **0604.50**

The customer's folder usually includes a copy of the car invoice, customer's (car) purchase order, conditional sales contract, and other memoranda. The extent of testing will be determined by the volume of sales and the number, nature and measure of any exceptions noted.

The wholesale value given in the current Kelley Blue Book may be used as a guide in determining whether value of the trade-in is the "fair market value". The wholesale value is defined as the "average cash value of a clean car fully reconditioned." In many instances a dealer will allow the wholesale "Blue Book" less costs of reconditioning which is a "fair market value". Information pertaining to underallowances is included in Section **0604.52**.

Particular attention must be given to the comparison of car orders and invoices in those dealerships where the customer is not furnished a copy of the invoice.

The status of the conditional sales contract as a controlling document has been recognized by legislation through the Rees-Levering Motor Vehicle Sales & Finance Act, effective 1-1-62. It requires that all aspects of agreements between the buyer and seller of a motor vehicle be contained in a single conditional sales contract. It also required that the contract set forth as a separate item the cash price of the motor vehicle described in the conditional sales contract.

## UNDERALLOWANCES ON TRADE INS

0604.52

Regulation 1654 notes that total sales include agreed allowances for property traded in. The regulation further notes that when the Board finds that the allowance is less than the fair market value, it shall be presumed that the allowance was such market value.

When underallowances are suspected, the auditor should ascertain whether this is a regular practice. This may be done by demonstrating that recorded trade-in allowances are consistently below market value, or that gross profit margins are consistently lower on transactions involving trade-ins than on transactions without trade-ins.

In determining fair market value, Kelley Blue Books may be used as a guide. However, it should be carefully noted that the wholesale values provided by this reference are average values for clean, fully reconditioned automobiles. The auditor should be alert to trade-ins which do not meet this definition. A below average trade-in allowance for an automobile in poor condition should not be treated as an underallowance. The subsequent sale of a trade-in at a less than normal price, expenses incurred by the dealer to repair or recondition the trade-in, may indicate that the automobile traded-in was not in average condition.

## OVERALLOWANCES TAKEN AS DISCOUNTS

0604.55

Some instances may be found where dealers net from gross sales, or claim as a cash discount on their return, amounts allowed on used car trade-ins in excess of actual value of the trade-in. These excess amounts are known in the trade as overallowances. *Such overallowances are not deductible as discounts.* An example of a transaction of this nature is illustrated below:

Manufactures list price is \$4000

Trade-in has a value of \$1000

	<i>Car Order</i>	<i>Invoice</i>	<i>Contract</i>
Price of car:	\$4000	\$4000	\$4000
Sales Tax:	240	210	240
License:	40	40	40
	\$4280	\$4250	\$4280
Trade-in Allowance:	1580	1050	1580
Discount:	0	500	0
Balance:	<u>\$2700</u>	<u>\$2700</u>	<u>\$2700</u>

In the case of a cash sale, only the car order and invoice will exist and the agreement between the parties is evidenced by the car order. In the conditional sale, the agreement of the parties is evidenced by the conditional sales contract. In either case, the measure of tax is \$4000.

## DISCOUNTS

0604.60

Virtually all new car dealers allow a discount on new vehicle sales. The amount of discount on any sale will be reflected on the documents of sale, and recorded in the sales journal as a discount. Discounts are netted from gross sales on the financial statements, either by decreasing sales or by showing the amounts of discounts as minus amounts on the statements. New car dealers will vary in their method of handling the discounts for reporting purposes. Some will segregate those amounts which are not valid discounts and add them to total sales, while others will add the total discounts to total sales and claim a deduction for the valid discounts. The mechanics of handling the discounts per the general ledger will be clear from the financial statements and sales tax working papers.

The auditor is more concerned with establishing the validity of the recorded discounts. The examination of the car journals, and the reconciliation of the sales tax accrual account usually will disclose a dealer's practice of charging tax on the gross amount before discount. The more common practice, which is not apparent from the formal records, in mishandling discounts is the lack of agreement of documents. The wide range of errors that can occur with discounts is illustrated in the following examples.



## EXAMPLE 1—TAX ON GROSS

Situation: Recorded and reported amounts are based on the sales invoice and discount of \$500 claimed or netted. Reported measure of tax is \$3500.

	<i>Car Order</i>	<i>Sales Invoice</i>	<i>Conditional Contract</i>
Selling Price	\$4000	\$4000	\$4000
Sales Tax	240	240	240
License	80	80	80
TOTAL	<u>\$4320</u>	<u>\$4320</u>	<u>\$4320</u>
Settlement:			
Discount	\$ 500	\$ 500	
Down Payment	1000	1000	\$1500
Contract in Transit/Proceeds	2820	2820	2820
TOTAL	<u>\$4320</u>	<u>\$4320</u>	<u>\$4320</u>

Discussion: Discount is not allowable since tax was computed on the gross selling price.

## EXAMPLE 2 — INFLATED CONTRACT

Situation: Recorded and reported amounts are based on the sales invoice and discount of \$500 claimed or netted. Reported measure of tax is \$3500. Proceeds from contract coincide with contract in transit. Selling price, tax and down payment were inflated on the contract in order to obtain lending institution acceptance.

	<i>Car Order</i>	<i>Sales Invoice</i>	<i>Conditional Contract</i>
Selling Price	\$4000	\$4000	\$4600
Sales Tax	210	210	276
License	80	80	80
TOTAL	<u>\$4290</u>	<u>\$4290</u>	<u>\$4956</u>
Settlement:			
Discount	\$ 500	\$ 500	\$ 500
Down Payment	1090	1090	1756
Contract in Transit/Proceeds	2700	2700	2700
TOTAL	<u>\$4290</u>	<u>\$4290</u>	<u>\$4956</u>

DISCUSSION: The discount is not a factor for consideration. The contract is the final document indicating agreement of the parties, and since sales tax reimbursement is computed on the inflated amount, tax of \$276 is due. The audited measure of tax is \$4600.

## EXAMPLE 3 — INFLATED CONTRACT

Situation: Recorded and reported amounts are based on the sales invoice, and discount of \$500 claimed or netted. Reported measure of tax is \$3500. Proceeds from the contract coincide with contract in transit. Selling price per contract includes tax and license, and contract was inflated to obtain financing.

	<i>Car Order</i>	<i>Sales Invoice</i>	<i>Conditional Contract</i>
Selling Price	\$4000	\$4000	\$4800
Sales Tax	210	210	
License	80	80	.
TOTAL	<u>\$4290</u>	<u>\$4290</u>	<u>\$4800</u>
Settlement:			
Discount	\$ 500	\$ 500	\$ 500
Down Payment	1090	1090	1600
Contract in Transit/Proceeds	2700	2700	2700
TOTAL	<u>\$4290</u>	<u>\$4290</u>	<u>\$4800</u>

DISCUSSION: In the absence of a separate statement of tax reimbursement and license on the contract, it is assumed that the gross amount includes both and the measure of tax is computed as follows:

Gross	\$4800
Less: License Fee	80
Net	\$4720
Less: Sales Tax Included	267
Audited Selling Price	<u>\$4453</u>

## EXAMPLE 4 — TAX INCLUDED IN DISCOUNT

Situation: Recorded amounts are based on the car order, which also serves as the invoice.

Reported measure of tax is \$3528  $\left[ \frac{4240 - 500}{106} \right]$

The conditional sales contract notes that sales tax is included at 5.660%.

	<i>Car Order</i>	<i>Sales Invoice</i>	<i>Conditional Contract</i>
Selling Price	\$4000		\$4000
Sales Tax	240		240
License	80		80
TOTAL	<u>\$4320</u>		<u>\$4320</u>
Settlement:			
Discount (Incl. sales tax @ 5.660%)	\$500		\$500
Down Payment	1040		1040
Contract in Transit/Proceeds	2780		2780
TOTAL	<u>\$4320</u>		<u>\$4320</u>

DISCUSSION: The agreement of the parties reflects sales tax included in the discount on both the car order-invoice and the contract. The proper measure of tax has been reported, regardless of the fact that recorded amounts do not reflect adjustments of tax accrual and discounts.

It should be noted that discounts, e.g., cash rebates given by a dealer to a customer in cash or as credit on the financing contract, or as a reduction in the selling price of the property, are not part of the dealer's gross receipts. For periods prior to January 1, 1979, dealers who charge tax on the gross amount before discount collect excess tax reimbursement since tax is being charged on an amount (discount) which is not part of gross receipts. Examples 1, 2, and 3 are cases where excess tax reimbursement has been charged.

When such instances are noted, the auditor should not include the excess tax in the audit until the dealer has been given an opportunity to refund the excess tax to his customers. In all cases, the auditor should encourage the dealer to refund the excess tax since it has been erroneously charged. (See Section 0417.05.)

For periods on and after January 1, 1979, if a retailer adds to the sales price of tangible personal property sold at retail an amount represented to the customer as sales tax reimbursement in excess of the amount due and does not return the amount to the customer, the amount will be regarded as part of the price of the property sold. The retailer will be regarded as having sold the property for a price which includes sales tax reimbursement. Since gross receipts do not include cash discounts, the tax-included sales price will be the gross amount of the sale, less the cash discount.

## **RETURNED MERCHANDISE – RESCINDED SALES**

**0604.65**

The accounting systems provided by the major manufacturers do not provide specific means for canceling sales or recording returns of merchandise already recorded in the various sales journals. New and used car dealers will follow one of the following methods:

One method which might be employed would be by a journal entry. The auditor would ordinarily examine these journal entries with deviations from prescribed procedures becoming readily apparent.

Another method occasionally employed, and more often by used car dealers, is the lining out of the entry in the sales journal, especially if the return or cancellation is within the reporting period of the original sale.

The usual method, however, used by both new and used car dealers, is to reverse the transaction in the same sales journal in which it originally appeared. Such transactions are referred to in the trade as "roll backs".

Since the footing of and the posting from the sales journal will be net of "roll backs" as well as lined-out entries, the auditor must establish the amounts netted as being valid exclusions from taxable sales.

Occasionally, a vehicle originally sold by a dealer will be taken in trade on another sale within a short time after the first sale and the dealer will enter the trade as a "roll back".

Some dealers will "roll back" vehicles repossessed within a highly short period of time after sale, especially if it is voluntary on the part of the customer.

In each case, the auditor should examine the customer's folder for receipts for refund of down payments, return of his trade-in, and for various correspondence, memos, notes, charges, etc., which could give clues as to the validity of the deduction.

## **LICENSE FEES AND IN LIEU TAXES**

**0604.70**

The Vehicle License Fee Law imposes a license fee for the privilege of operating in this State any vehicle of a type subject to registration under the Vehicle Code. This license fee, and the tax, in lieu of personal property tax, must be paid before plates will be issued for a new car or before current year plates will be issued for used cars equipped with prior year plates.

## **IN CONNECTION WITH NEW CARS**

**0604.75**

The new car dealer, as a practical matter, may collect the amount of the license fee and in lieu tax involved and remit it to the Department of Motor Vehicles. In such cases, the dealer is merely accommodating the purchaser in remitting the fee, and the tax does not apply to the amount of fees paid by the dealer. If the amount collected from the purchaser exceeds the amount required to be remitted to DMV, excess fees collected are to be included in the additional measure of tax. The auditor should, therefore, examine the "License Fees" account in the general ledger for unreported taxable license fees collected.

## **IN CONNECTION WITH USED CARS**

**0604.80**

In the case of used cars as well as new cars registered in the dealer own name, license fees and in lieu tax paid by the dealer to the Department of Motor Vehicles prior to the time of sale are not a part of taxable gross receipts when added to the selling price of the vehicle under Sections 6011 and 6012 of the Sales and Use Tax Law. (*This exemption does not apply to trailers, semitrailers, and dollies.*)

Sometimes a dealer will add an amount for “license” to a unit on which the fee was paid by someone else prior to the dealer acquiring the car. This charge is taxable since the dealer did not pay the fee to the Department of Motor Vehicles. Only when a used car is licensed by the dealer can the license fee be deducted from taxable sales when it is stated as a separate item to the customer.

## **DOCUMENTARY FEES**

**0604.82**

A charge for “documentary fee, or fees” may be made by same automobile dealers for the preparation of documents in connection with the sale of a vehicle, such as transfer papers required by the Department of Motor Vehicles. Such documentary fee and the charge therefor may be preprinted on the car purchase order, or typed, or written in by the automobile dealer. These charges are taxable as part of the selling price of the vehicle on which tax is computed.

Legislation allowing dealers to exclude documentary fees of up to \$20 from the advertised price of vehicles effective January 1, 1979, does not change the taxability or the need to include such preparation charges in the gross receipts subject to sales tax.

## **LUBE BOOKS**

**0604.85**

*When lube book charges have been included in the selling price of a new car on which tax has been computed, the auditor will include such charges in audited total sales.*

When the lube books are sold ex-tax, the method of handling redemption of the coupons will be determined in the examination of repair orders to establish liability, if any, for grease.

## **UNDERSEAL AND PORCELAINIZE**

**0604.90**

Amounts of these sales vary, and in many dealerships, are non-existing. One of two methods of recording the sales in the new car journal is usually employed — the first being a credit to an inventory account, and the second a credit to labor or sublet repair sales. If these charges are part of the new car selling price, they must be included in taxable sales.

## **DELIVERY CHARGES**

**0604.95**

The majority of dealers do not make separate charges for delivery. When they are involved, the charges are nominal and must be examined for compliance with the provisions of Regulation 1628, Delivery Charges.

## **ESCROW FEES ON MOBILE HOMES**

**0604.98**

Effective January 1, 1980, separately stated escrow fees on the sale of purchase of a new or used mobile home shall be excluded from the terms “gross receipts” and “sales price” for sale and use tax purposes.

## **OTHER SALES OF NEW AND USED VEHICLES**

**0605.00**

### **SALES OF COMPANY CARS AND SERVICE CARS**

**0605.05**

The method of recording sales of company cars and service cars varies. The fact that the unit is sold is, of course, determined from the credits to the respective asset accounts. In some cases the sale is recorded by general journal entry, and in others the sale is invoiced and entered in the sales journal, but postings are to the general column rather than a sales column. The car may be transferred to new or used car inventory, and the sale recorded as a routine sale.

The method employed should be clear after examination of the general ledger accounts and sales tax working papers.

### **SALES OF REPOSSESSIONS**

**0605.10**

Repossessions are divided into two categories, voluntary and involuntary. The latter are more common and are usually reflected in the dealer's books as inventory items as the balancing debit entry to the disbursement of money to the lending institution. Examinations of general ledger accounts and used car journals establish the proper handling of involuntary repossessions. There is a gap, however, that must be recognized by the auditor. That is, that a time lag often exists between the time of repossession and the demand for payment against the dealer under the recourse provisions of the contract. During this period the owner may reinstate or refinance the car. Also during this period the dealer, if the car is on his premises, will attempt to negotiate a sale if reinstatement is not effected. In the event a sale can be arranged before the demand payment is due, the dealer may treat the transaction as a transfer of equity or write a new contract with the proceeds applying against the demand amount.

The voluntary repossession results when the original purchaser presents the car to the dealer of his own volition, and without the knowledge of the lending institution. This allows the dealer more latitude in time in securing a buyer before the demand payment is issued.

Audit procedures are parallel to those discussed in transfers of equity and consigned cars. (See Sections **0605.15** and **0605.20**)

### **TRANSFERS OF EQUITY**

**0605.15**

A transfer of equity, in the true sense, is a sale between two individuals in which the purchaser assumes the conditional sales contract balance of the seller.

A true transfer of equity, in which the dealer has no function other than the approval of the transferee, results in no additional tax liability to the dealer. If, however, the dealer assists to the extent of displaying the car on his lot, or obtaining the transferee and negotiating the transfer at the dealer's place of business, a sale subject to sales tax has occurred. If the dealer's participation extends only to bringing the two parties together with the negotiations handled by the parties and the lending institution, the dealer has no liability.

The involvement of dealers in these transfers occurs since the dealer wrote the original contract and has future liability on recourse paper in the event of default. A transfer of equity usually arises because the buyer has overextended himself financially, and the likelihood of repossession is probable. The dealer in order to forestall a repossession may attempt to encourage a transfer of equity.

Evidence of transfers ordinarily will not be found in sales journals or any other formal records. The dealer's reserve statement is the only supporting document reflecting transfers of equity. This statement will show the change in names, but examination of these statements is awkward and not a recommended procedure. Evidence of equity transfers are most likely to be found in a customer folder prepared on the transferee.

## **TRANSFERS OF WARRANTIES**

**0605.17**

A transfer of a mandatory warranty is a transfer of the obligation of the manufacturer to provide replacement parts and/or labor pursuant to the warranty to the new owner in the event that such parts and/or labor are needed and is not a sale of tangible personal property. Warranty transfer fees are therefore not subject to sales tax.

Such a warranty remains in existence and follows the ownership of the automobile until the period of its effectiveness has expired. Parts provided and used after a warranty has been transferred are, for the purpose of the law, purchased at the time of the original sale; and since the warranty applies to the automobile itself, the furnishing of parts pursuant to the warranty, either to the purchaser/owner or to subsequent owners, is not subject to sales tax. The sale of the replacement parts and materials to the seller furnishing them thereunder is a sale for resale and not taxable (See Sales and Use Tax Regulation 1655(c)(2).)

## **CONSIGNED CARS**

**0605.20**

Consigned cars are usually customers' used cars which the dealer sells in behalf of customers. The car does not become a part of inventory, and the transfer to the buyer is not always effected on a dealer's report of sale. In some cases, a consignment agreement is prepared and is the basis for acceptance of an offer and settlement of monies. In the true consignment sale the dealer has possession of the car and displays the unit with the used car inventory.

Generally, the dealer holds out to the prospective buyer that the car is a part of his inventory. Therefore, monies received will be reflected in cash receipts, and settlement of account with the consignor will be by credit to accounts receivable in the cash receipts journal or remittance in the cash disbursements journal. Expense of preparing the car for sale will often be reflected by a repair order. If the buyer must finance the car, the contract will be reflected along with the receipt of proceeds.

## **ACCOMMODATION SALES**

**0605.25**

Accommodation sales differ from consignment sales in that the cars are usually the personal cars of management personnel, salesmen or employees. It is immaterial that the car was displayed at the dealer's place of business. The dealer will be liable for sales tax under Regulation 1566, Automobile Dealers and Salesmen, only if one of the following occurred:

- a) The dealer prepared a dealer's report of sale.
- b) The dealer executes a conditional sales contract on which the dealer's name appears as seller.

## **ACCOMMODATION REGISTRATIONS AND DELIVERIES**

**0605.30**

Many automobile manufacturers occasionally request a franchised dealer to receive a vehicle, prepare it for delivery, complete a Dealer's Report of Sale, and deliver the vehicle to the manufacturer's employee or an employee of a subsidiary company. Where the vehicle is registered in the name of the manufacturer or a division thereof, there has been no sale and the manufacturer is liable for use tax on the vehicle cost as indicated in Section **0606.07**. Where the vehicle is registered to a subsidiary company, the manufacturer is liable for the sales tax measured by the intercompany transfer price. The dealer should be held accountable for the tax on such accommodation deliveries only if it was collected by the dealer.

If accommodation registrations and deliveries as described above are noted during audits of local dealers, the auditor should prepare an audit memorandum, Form BT-1164, and forward it to the Out-of-State District. The memorandum should indicate the manufacturer's invoice number, date, vehicle identification number, the purchaser's name as shown on the invoice and as shown on the Dealer's Report of Sale, and whether tax was collected and reported by the dealer.

## **COURTESY DELIVERIES — FACTORY DIRECTED**

**0605.35**

A factory directed courtesy delivery is a transaction in which an out-of-state dealer sells a vehicle to a customer but directs the manufacturer to make delivery to the customer at a specified location in California. The manufacturer delivers the vehicle to a local California dealer who redelivers it to the customer. The delivering dealer normally charges the manufacturer for new car preparation but the vehicle is not entered in the dealer's inventory and very often the dealer does not prepare a report of sale.

If courtesy deliveries to customers are made at the direction of manufacturers not engaged in business in California, they should be included in the audited sales of the delivering California dealer. The California dealer is considered to have made a retail sale under the second paragraph of Section 6007.

## **COURTESY DELIVERIES — FACTORY DIRECTED — FOREIGN SALES 0605.40**

Domestic automobile manufacturers have programs whereby dealers in foreign countries negotiate sales of American made automobiles to persons wishing to take delivery in California. These vehicles are sold primarily to U.S. Military Service Personnel and State Department employees returning to the States from overseas assignment. These sales are, for the most part, negotiated at U.S. Military Post Exchanges in foreign countries and the orders are transmitted to the manufacturer's foreign marketing organization for acceptance. The manufacturer is directed to make delivery to the customer at a specified location in California.

## **COURTESY DELIVERIES — NOT FACTORY DIRECTED 0605.45**

This type of courtesy delivery involves a delivery from the dealer's inventory to a customer of an out-of-state dealer based on direct correspondence between the prospective dealers, and without participation by the manufacturer. The local dealer will invoice the out-of-state dealer for the car. Deliveries in this state to the out-of-state dealer's customers are taxable to the delivering dealer pursuant to Section 6007.

There is sometimes a question whether the person taking possession of the car in California was a "driver" for the out-of-state dealer or the ultimate customer. In this case, the auditor may request that the out-of-state dealer furnish a copy of the out-of-state registration.

The relief of inventory and charge to the out-of-state dealer is usually effected through the New Car Purchase Journal. Since such credits to inventory are offset against purchases, and the net debit is posted to the general ledger account, no indication of this type of delivery is found during examination of the general ledger. Nor will an examination of the DMV Reports of Sale disclose all courtesy deliveries since with many of the deliveries the out-of-state dealer furnishes plates of his state.

A detailed scrutiny of all credits to inventory in the New Car Purchase Journal is therefore necessary. Questioned items should be scheduled. In some instances invoices for sales to other dealers will be prepared and maintained separately. Examination of such invoices will usually establish that the majority of credits involve trading of cars between recognized dealers in the same locale. These will usually be sales for resale. However, some trades may be questionable, as for example, the transfer of a Chevrolet truck to a Pontiac dealer for use as a parts department truck.



## **SELF-CONSUMED MERCHANDISE**

**0606.00**

### **GENERAL**

**0606.05**

In general, the verification of self-consumed merchandise of an automobile dealer will follow that of any other retailer; however, there are some special aspects involving demonstrators, company cars, service cars, maintenance of these cars, and other items. The circumstances and the special provisions applicable thereto are discussed in the following sections.

### **MANUFACTURERS AND DISTRIBUTORS OF MOTOR VEHICLES**

**0606.07**

Motor vehicle manufacturing and distributing companies sometimes use vehicles of their own for purposes which give rise to use tax liability.

Effective 10-1-76, for vehicles assigned for more than 12 months to persons for combined business and personal use and demonstration and display, or assigned to "pool service"; Manufacturers must pay the tax on the purchase price of tangible personal property used to manufacture the vehicle, and distributors must pay tax measured by their purchase price of the vehicle. When manufacturers and distributors either assign vehicles to persons for less than 12 months, or assign "pool" service vehicles to visiting dignitaries, etc., for less than 12 months, the measure of tax is the fair rental value based upon  $\frac{1}{40}$ <sup>th</sup> of the net dealer purchase price for each month of combined demonstration or display and use.

### **VEHICLES CAPITALIZED AS ASSETS (Regulation 1669.5)**

**0606.08**

Except for vehicles held for the purpose of leasing, vehicles which are capitalized in an asset account and depreciated for income tax purposes are not held for sale in the regular course of business. Tax must be paid measured by the purchase price of such vehicles.

### **REGISTRATION (Regulation 1669.5)**

**0606.09**

If a vehicle manufacturer, distributor, dealer, or lessor registers a vehicle purchased for resale in a name other than that of the manufacturer, distributor, dealer, or lessor while retaining title to the vehicle, the vehicle is not held for sale in the regular course of business; and the manufacturer, distributor, dealer, or lessor must pay use tax measured by the purchase price of the vehicle.

The only exception is the loan of vehicles to school districts, California State Colleges, the University of California and veteran's hospitals for driver education purposes as provided in Regulation 1669.5(a)(4). Issuance of exempt plates is limited to governmental bodies by regulations of the Department of Motor Vehicles as the vehicles must be registered to them. Use tax will not apply in such cases.

### **RECORDING OF CARS USED AS DEMONSTRATORS**

**0606.10**

Dealers usually record cars placed in demonstrator service in an inventory account separate from the regular new car inventory. The account will be titled "Company Cars" or "Demonstrators". Depreciation is not claimed for income tax purposes on the cars recorded in these accounts. These accounts usually include the cost of demonstrators, as well as those cars assigned to salesmen, officers, partners, officials, and other employees. It may also include courtesy cars.

This transfer from the regular new car inventory account to the company car and/or demonstrator inventory account, is usually accomplished by an entry or series of entries in the general journal. In some instances, no entry will be made in the records, the cost of the cars being allowed to remain in the regular new car inventory account. Evidence of this being the case usually can be detected in one or more of the following ways:

- a) Cryptic notations or signals in sales journals or on detailed new car inventory records.
- b) Entries in demonstrator expense accounts, internal sales, etc.
- c) Evidence of insurance coverage.
- d) Notations on documents covering subsequent sales of demonstrators.
- e) Department of Motor Vehicles Report of Sales. (Under the Motor Vehicle Code, dealers may operate demonstrators and company cars on dealer plates. The absence of a registration does not, therefore, preclude a taxable use of a car by the dealer.)



## **RENTAL TO SALESMEN FOR DEMONSTRATION (Regulation 1669.5)**

**0606.12**

A dealer who rents vehicles which are not mobile transportation equipment to his salesmen is regarded as making continuing sales of the vehicles and must collect and pay tax on the rental receipts, unless he has paid tax measured by the purchase price of the vehicles. However, if the rental receipts are less than  $\frac{1}{60}$ <sup>th</sup> of the dealer's purchase price of the vehicle for each month of the rental, the transaction will not be considered a bona fide rental, and tax will be measured by  $\frac{1}{60}$ <sup>th</sup> of the purchase price for each month of such use. Tax applies to sales by dealers to their salesmen of vehicles to be used for demonstration and personal use.

## **DEMONSTRATION AND DISPLAY**

**0606.15**

Regulation 1669, Demonstration and Display, provides that a purchaser of tangible personal property who gives a resale certificate therefore, and who uses the property solely for demonstration or display while holding it for sale in the regular course of business, is not required to pay tax on account of such use. Demonstrators owned by dealers who do not allow their personnel to use such vehicles for purposes other than demonstration and display fall within the exemption.

## **TYPES OF VEHICLES NOT ORDINARILY SOLD (Regulation 1669.5)**

**0606.17**

If a vehicle dealer or lessor purchases under a resale certificate a new vehicle of a type which he is not franchised to sell, or does not ordinarily sell or lease as a new vehicle, and uses the vehicle for any purpose other than, or in addition to, demonstration or display, it will be presumed that he is not holding the vehicle for sale in the regular course of business and that tax is due and measured by the purchase price of such vehicle.

## **APPLICATION OF TAX TO DEMONSTRATORS**

**0606.20**

Dealers or lessors who allow their employees to use vehicles for purposes other than demonstration and display are liable for the tax on the fair rental value of the vehicles for the period of such other use.

Dealers who give resale certificates and then use automobiles for purposes other than demonstration or display while holding them for sale in the regular course of business are liable for use tax measured by the sales price of the automobile to them. However, when a series of vehicles are used in this manner for periods of less than six months, the use tax will be measured by the average cost of one vehicle for each 12-month period for each person to whom such cars are assigned. The average cost will be the weighted average of the cost of all vehicles so used by that particular person during the 12-month period. Tax applies to the subsequent retail sale of such vehicles.

Regulation 1669.5, effective October 1, 1976, establishes the presumptions listed below with respect to vehicles which are registered in the name of the dealer or lessor and vehicles which are not registered. The presumptions established by the regulation determine whether vehicles are frequently demonstrated and the measure of the fair rental value. These presumptions may be rebutted only by clear and convincing evidence to the contrary.

- When a vehicle dealer or lessor assigns a demonstrator to his vehicle sales personnel for a period not exceeding 12 months, the measure of tax is the fair retail value at  $\frac{1}{60}$ <sup>th</sup> of the purchase price for each month of combined demonstration or display and use.
- When a vehicle dealer or lessor assigns a vehicle to employees or officers other than vehicle sales personnel for a period not exceeding 12 months, the measure of tax is the fair rental value at  $\frac{1}{40}$ <sup>th</sup> of the purchase price for each month of combined demonstration or display and use.
- When a vehicle dealer or lessor assigns a vehicle to a person other than an employee or officer, such as a relative or business associate, the measure of tax is the purchase price of the vehicle.
- When a dealer or lessor assigns a vehicle to a person for more than 12 months for business or personal use in addition to demonstration and display, the measure of tax is the purchase price of the vehicle. The  $\frac{1}{40}$ <sup>th</sup> or  $\frac{1}{60}$ <sup>th</sup> formula, as appropriate, may be used if the duration of combined use is not known at the outset, with the difference between cost and the formula to be paid when use exceeds 12 months.
- When a vehicle is purchased for resale and registered in the name of the dealer, the measure of tax is the fair rental value computed at  $\frac{1}{40}$ <sup>th</sup> of the purchase price for each month of combined demonstration or display and use.

The following table illustrates the tax application to demonstrator vehicles which are also used partly for purposes other than demonstration and display.

VEHICLE OPERATOR	PERIOD VEHICLE IN DEMO SERVICE	BEGINNING 10-1-76
Sales personnel	12 months or less	$\frac{1}{60}$ <sup>th</sup> of cost
Sales personnel	more than 12 months	Cost less reported demo credit
Nonsales personnel	12 months or less	$\frac{1}{40}$ <sup>th</sup> of cost
Nonsales personnel	more than 12 months	Cost less reported demo credit
Nonemployees	No requirement necessary	Cost

#### USED CAR DEALERS

A number of situations, which are often encountered when auditing used car dealers, require consistent handling.

- Where a used car dealer is found to be taking different cars for business and personal purposes rather than using one car for an extended period, it is reasonable to assume they are frequently demonstrated and displayed and the use of the  $\frac{1}{60}$ <sup>th</sup> formula is appropriate.
- Where the used car dealer is using one car for an extended period of time, additional proof of frequent demonstration and display is required if the  $\frac{1}{60}$ <sup>th</sup> formula is to be used in lieu of the "cost of one car per year" method.
- Generally, a new car purchased by a used car dealer or a new car dealer not franchised to deal in the type of car purchased, is not frequently demonstrated and displayed, but rather purchased for personal use. Accordingly, unless there is convincing evidence to the contrary, such automobiles should be tax-paid on cost. An example is a Volkswagen dealer purchasing a Cadillac under a resale certificate.

#### VEHICLES LOANED TO CUSTOMERS

**0606.25**

On cars loaned to customers who are awaiting delivery of vehicles purchased or leased from the dealer, or while the customer's car is being repaired by the dealer, the measure of tax liability is the fair rental value of the vehicle for the duration of each loan so made. If a specific charge is made for use of the vehicle such charge shall be considered to be the fair rental value. If the dealer has previously reported tax on the cost of a vehicle which is loaned to customers, no additional tax is due.

When a lessor loans a vehicle to his lessee who is awaiting delivery of a leased or repaired vehicle, and the regular lease payments continue to accrue during the period of the loan, the regular lease payments will be considered to cover the use of the substitute vehicle.

When a dealer or lessor loans a vehicle for 30 days or less to a person other than a customer awaiting delivery of a vehicle, tax is due on the fair rental value, providing this incidental use is preceded and followed by frequent demonstration and display. However, tax must be measured by the purchase price of the vehicle if it is not frequently demonstrated and displayed, and the use both exceeds 30 days and is not of an incidental nature.

#### VEHICLES LOANED TO OTHERS

**0606.27**

When cars are loaned to persons who are not customers awaiting delivery of a car purchased or leased from the dealer, or the return of the customer's car being repaired by the dealer, there is no provision to measure use tax liability by other than the purchase price. However, if such loans are for very short periods of time, interspersed with frequent demonstration or display while holding the vehicle for sale in the regular course of business, the tax liability may be based on the fair rental value.

#### COMPANY CARS

**0606.30**

Company cars are those vehicles available chiefly for company use by employees and with very little use, if any, for demonstration and display. *These cars will usually be recorded in the same account as demonstrators. The dealer must include the cost of such vehicles in the measure of tax paid by him. In the case of vehicles owned by factory branches, use tax would, of course, apply to the material used in manufacturing the car.*

## SERVICE CARS

**0606.35**

The cost price of service cars, parts and service department vehicles, and tow trucks would be subject to tax.

**New Vehicles:** The accounting systems prescribed by the major manufacturers require the cost of these vehicles to be capitalized in a fixed asset account and depreciated for income tax purposes. The account will usually be known as “Service Cars” or “Equipment”.

**Used Vehicles:** All automobiles acquired by dealers from non-retailers as well as other dealers are subject to the use tax if placed in company service. The dealer would normally register the vehicle to the dealership by use of a used car report of sale. No use tax would be paid to the DMV on a transaction handled in this manner, hence the auditor should be alert for undeclared use tax as a result of such transactions.

## LOANS TO SCHOOLS, COLLEGES, AND VETERANS’ INSTITUTIONS FOR EDUCATIONAL OR TRAINING PROGRAM

**0606.40**

Section 6404 of the Sales and Use Tax Law exempts a retailer from the use tax on tangible personal property loaned to any school district for an educational program conducted by the district.

When a vehicle or tangible personal property is leased or sold to the school district, tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold. School districts include only tax-supported districts of a city or county; they do not include private schools.

Section 6404 of the Sales and Use Tax Law extends the use tax exemption to the loan by any retailer of any motor vehicle to:

- a) California State Colleges or the University of California for the exclusive use in an approved driver education teacher preparation certification program.
- b) An accredited private or parochial secondary school for the exclusive use in a driver education and training program approved by the State Department of Education as a regularly conducted course.
- c) A Veterans Hospital or such other nonprofit facility or institution to provide instruction in the operation of specially equipped motor vehicles to disabled veterans.

When a vehicle is leased or sold to (a) or (b), tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold. When a vehicle is leased or sold to (c), tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold to any nonprofit facility or institution other than the Veterans Administration.

Refer to Section [0606.09](#) for registration qualifications when the organization to which the vehicle is loaned is a governmental body.

## RENTALS TO OTHER THAN EMPLOYEES

**0606.45**

Dealers may rent vehicles to persons other than employees under the provisions of Regulation 1660 Leases of Tangible Personal Property — In General. Besides rentals to persons in no way connected with the dealership, dealers sometimes rent to members of the families of management personnel who do not qualify under Regulation 1669.5. The amount of rental must be commensurate with the value of the car; and if it is not, the cost of the car must be included in the additional measure of tax.

## COMPANY AND SERVICE CAR REPAIRS AND MAINTENANCE

**0606.50**

Expenses for repairs and maintenance of company cars and service cars are recorded as Demonstration Expense or Company Car Expense. The cost is recorded in the internal journal based on repair orders or counter sales invoices. In examining the detail of the posting to expense, auditor can ascertain the internal sales account credited, which will be the basis for establishing self-consumption. Treatment of the expense items taxwise is as follows:

TYPE OF VEHICLE	GASOLINE OIL, GREASE	PARTS ACCESSORIES
Cars taxable on $\frac{1}{40}$ <sup>th</sup> or $\frac{1}{60}$ <sup>th</sup> formula basis	Taxable	Non-taxable
Vehicles used as demonstrators only	Taxable	Non-taxable
Loan cars taxable on fair rental value	Taxable	Non-taxable
Loan cars tax paid on cost	Taxable	Taxable
Company cars, service cars, tow trucks	Taxable	Taxable
Vehicles held for sale only and neither demonstrated nor used	Non-taxable	Non-taxable

## PAINT DEPARTMENT

**0606.55**

Where the dealer is engaged both in the sale of paint and its use in the service department for repainting customers' cars, he is considered the consumer of paint purchased for resale and used in repainting customers' cars (Regulation 1551, Repainting and Refinishing). The cost of paint so used should be reported as self-consumed merchandise.

Paint sold to customers will be recorded on counter sales invoices and reflected as sales of the Parts Department. Charges for repainting customers' cars are made on repair orders and recorded in the parts, accessories, and service journal. Special paint jobs in conjunction with new car sales are recorded in the new car journal and are taxable as part of the new car selling price.

The auditor should establish the source of paint sales from examination of ledger accounts, and in turn the method of recording from the respective journals. The status of purchases being tax paid or ex-tax is readily established from purchase invoices.

On repair orders for repainting a customer's car, some dealers make a separate charge for paint material. If this is done, the dealer is selling paint at retail and is not the consumer as mentioned above.

## GREASE AND OIL

**0606.60**

Dealers are consumers of grease and oil used in the performance of lubrication service. The majority of dealers purchase these materials ex-tax, since some portion will be used in used car reconditioning and new car preparation. In these cases, the lubricant is sold with the car and no liability for self-consumed exists. Liability for materials used on redemption of lube coupons is based on dealers handling of lube book sales. (See Section [0604.85](#))

## MISCELLANEOUS PURCHASES

**0606.65**

A test will usually be made of purchase invoices, with the extent of test based on size of dealership, prior audit findings, and the experience of the auditor. Purchases of fixed assets and expense items subject to use tax are the type of purchases most readily found.

Advertising specialties often are a major item. While license frame holders and key cases are normally in this category and purchased ex-tax, the majority of dealers provide these items with the new or used car and thus sell the frames or key cases with the car.

The nuts, bolts and cotter pins are often charged to an expense account when purchased. However, these items are considered as sold along with the part with which they are used. Therefore, if parts are sold, no measure of self-consumed merchandise would exist for the cost of these supplies. Some nuts and bolts are used on repair jobs on which no parts are sold and the cost of the supplies so used would be taxable.

The test should not be conducted in the initial stages of audit, but held in abeyance until the pattern of the dealer's operation is clear. The test is more meaningful if the examination is made to determine details of purchase of sublet repair charges, paint, grease, tools, and supplies in addition to use tax purchases.

**AUTO BODY REPAIR SHOP SUPPLIES**

**0606.70**

Many automobile body repair shops make a separate charge to their customers for the cost of "supplies" as an extension of their charge for repair labor. Such separate charges for "supplies" which do not become a component part of the refinished article are not subject to tax since title or possession of supplies is not transferred to the customer. However, if the evidence discloses that the charge for "supplies" is a surcharge on the sale of repair parts, the charge for "supplies" is subject to tax.

Generally, automobile body repair shops are considered the consumers of supplies, such as sandpaper, paint, thinner, abrasive, masking tape, etc.; and these items should not be purchased for resale.

## **SALES FOR RESALE**

**0607.00**

### **GENERAL**

**0607.05**

Verification of the deduction "Sales for Resale" should follow the same pattern as for other types of retailers. Resale certificates should be checked and their authenticity established in the usual manner, giving particular attention to isolated and nonrecurring sales which may disclose unauthorized or fraudulent use of resale certificates.

Examination of the various classes of resales to new car dealers, used car dealers, and leasing companies is discussed in the following sections.

### **NEW CAR RESALES**

**0607.10**

There are usually only two types of sales for resale of new cars. They are sales to other new car dealers, and sales to leasing companies. These latter sales are not sales for resale, but are sales for renting or leasing. Under the provisions of Regulation 1660, the lessor may give a resale certificate only if he intends to include all the rental receipts in the measure of tax which he reports.

### **RESALES TO LEASING COMPANIES**

**0607.15**

Most new car dealers will sell automobiles to leasing companies for resale. The number of units and the number of leasing companies to whom a dealer sells will vary from a very few companies to several and the number of units from one or two a year to several hundred a year.

The auditor should verify that every leasing company to whom the dealer has made sales for resale, has furnished the dealer with a valid resale certificate, and that the certificate indicates all cars purchased are for resale. If the auditor finds that a leasing company is buying both for resale and tax paid at source, all purchase orders from that leasing company should be carefully scrutinized.

The auditor should trace a representative sample of sales for resale to leasing companies to the Dealer's Report of Sale. For purposes of determining the validity of a resale certificate taken by a dealer, the person or persons named on the Dealer's Report of Sale and Application for Original Registration will be considered as the purchaser from the dealer. Unless the person named as the purchaser on the resale certificate is also shown on the Dealer's Report of Sale and Application for Original Registration, either singly or jointly pursuant to Section 4453.5 of the California Vehicle Code, the Board will consider the transaction a retail sale and subject to tax.

Section 4453.5 of the California Vehicle Code permits the registration of vehicles in the names of the lessor and the lessee with their relationships shown as "lessor" and "lessee" in the following manner:

All State Leasing Co., Lessor  
Robert J. Murphy, Lessee

If the joint form of registration is used, it is immaterial if the names are joined by "and" or "or".

To the lessor in care of the lessee. If the lessor elects to register the vehicle in this manner, the "care of" must include the designated lessee as follows:

All State Leasing Co.  
c/o Robert J. Murphy

or

All State Leasing Co., Lessor  
c/o Robert J. Murphy

If the name of a third person only is shown on the Dealer's Report of Sale and Application for Original Registration, the transaction will be regarded as subject to sales tax. The name of the third person would appear as:

Robert J. Murphy

or

Robert J. Murphy, Lessee



Lessors who own vehicles registered in the names of lessees only may have the registration changed to show either the lessor or the lessor and lessee relationship on the registration card. Where this is done they may continue to pay tax measured by the rental receipts. Further information on sales of vehicles to leasing companies is included in Regulation 1610 — Vehicles, Vessels, and Aircraft.

The auditor may find instances where a dealer sells cars to leasing companies for resale but does not register the cars by completing a Department of Motor Vehicles Application for Registration of Vehicle — New. If the dealer has a valid resale certificate from the leasing company, the auditor should prepare Form BT-1164, Record of Ex-Tax Transactions. Further information on Form BT-1164 appears in Section 0401.20.

Many new car dealers are now engaged in leasing cars to the general public. The leasing operation is usually a separate entity and conjunctive audits will, of course, be conducted;

### **NEW CAR RESALES TO USED CAR DEALERS**

**0607.20**

Occasionally a new car dealer will sell new vehicles to used car dealers, apparently for resale. In the event the dealer has claimed such sales for resale, the deduction will be allowed, only if the following conditions are met:

- a) The dealer has not registered the car to someone other than the used car dealer, and
- b) The dealer has a specific resale certificate from the used car dealer on file.

*An audit memorandum should be prepared on all sales of new cars by new car dealers, for resale, to used car dealers. In auditing the records of the purchaser (used car dealer), the fact should be verified that the vehicle or vehicles in question were actually purchased for resale and not for use.*

### **USED CAR RESALES**

**0607.25**

The auditor should question dealers' names he does not recognize, verifying that such dealers exist and that the permit number is correct.

Some dealers may record a retail sale on a "Used Car Wholesale" purchase order filling in a fictitious or legitimate dealer's name and permit number especially where they have in their possession vehicles on which the "Certificate of Ownership" (pink slip) has been signed in blank. Such transactions are subject to sales tax to the dealer.

### **PARTS AND ACCESSORIES**

**0607.30**

New car dealers are a prime source of supply of parts for garages and other auto repairmen. In some dealerships the sales of "Parts — Wholesale" constitute a major portion of the Parts Department operation, while in others this type of transaction is minor or negligible.

These resales are usually written on counter sales invoices and recorded in the Parts Accessory Journal. Testing of the counter sales invoices must be considered by the auditor based on volume, prior audit findings, and knowledge of the operation.

The auditor must be alert to combined taxable and non-taxable sales in the Parts — Wholesale and Accessories Sales accounts. Sales of parts to fleet users often are recorded in the wholesale account and tax charged. The incidence of this deviation is not easily detected except by examination of counter sales invoices; however, indications may be recognized from the sales tax accrual reconciliation. Some dealers will make separate totals of taxable and non-taxable in these mixed accounts.

## **U.S. GOVERNMENT SALES**

**0608.00**

### **U.S. GOVERNMENT PURCHASE ORDERS**

**0608.05**

The accounting procedures of the majority of instrumentalities of the Federal Government are such that purchase orders are mandatory. The seller is always given more than one copy of the purchase order and these copies are usually found in the customer folder. In the absence of the purchase order, correspondence is usually available which will give sufficient data to establish validity of the deduction.

### **DISABLED VETERANS' EXEMPTION**

**0608.10**

Sales of vehicles to disabled veterans may qualify for partial tax exemption. Any amount paid toward the purchase price by the Veterans Administration directly to the seller may be excluded from the measure subject to tax. The amount paid by the disabled veteran is taxable.

The documentation furnished by the Veterans Administration parallels that of purchases by the U.S. Government, and in addition requires the selling dealer to certify that the vehicle involved was actually sold to the claimant. The vehicle is registered in the purchaser's name and all other documents reflect the disabled veteran as the purchaser.

Verification of the validity of the deduction is readily made by examination of the customer folder.

### **FEDERAL EXCISE TAX**

**0608.15**

The federal retail excise tax imposed on the retail sale of heavy trucks and trailers is excluded from the measure of California sales and use tax. The federal tax is imposed on the retail sale of such vehicles and is therefore not part of the sales price subject to tax whether or not separately stated.

### **GOVERNMENTAL AGENCIES**

**0608.20**

Sales tax does not apply to sales to:

- The United States or its unincorporated agencies and instrumentalities.
- Any incorporated agency or instrumentality of the United States wholly owned by either the United States, or by a corporation wholly owned by the United States.
- The American National Red Cross, its chapters and branches.
- Incorporated federal instrumentalities not wholly owned by the United States, unless federal law permits taxing the instrumentality. Examples of incorporated federal instrumentalities exempt from tax are federal reserve banks, federal credit unions, federal land banks, and federal home loan banks.

Copies of government purchase orders or remittance advices should be retained in support of claimed exemptions.



## **FUEL SOLD OR CONSUMED IN NEW OR USED VEHICLES** **0609.00**

### **GENERAL** **0609.05**

Fuel placed into the fuel supply tanks of motor vehicles by manufacturers, importers, or dealers may be subject to California sales or use tax in whole or in part. The principles involved in the proper application of tax to fuel consumed or sold with a motor vehicle should be applied consistently at the manufacturer, importer, or dealer level.

### **FUEL SOLD WITH VEHICLES** **0609.10**

The fuel in the fuel tank of the vehicle at the time of sale is considered to be sold as part of the vehicle whether or not the charge for the fuel is separately stated. If the vehicle is sold at retail, sales tax applies to the selling price inclusive of the fuel. If the vehicle is sold for resale, the fuel is also considered to be sold for resale.

### **FUEL CONSUMED IN VEHICLES** **0609.15**

Fuel placed in the fuel tanks of vehicles by manufacturers, importers, or dealers and not sold with the vehicle is considered to be consumed and subject to tax. For example, fuel used by manufacturers or importers in testing, or preparing and loading vehicles for delivery, and fuel used by dealers for demonstration and personal or business use is subject to sales or use tax when consumed in California.

If fuel is purchased for resale, tax should be reported on the cost of the fuel not resold. If the fuel is purchased sales tax paid, a deduction for tax-paid purchases resold is in order measured by the cost of the fuel resold with vehicles. If fuel is purchased both for resale and sales tax paid, that which is purchased tax paid is considered to be consumed first, and that which is purchased for resale is considered to be sold first. If the fuel consumed exceeds the fuel purchased tax paid, tax should be reported on the cost of the excess. Conversely, if the fuel resold exceeds the fuel purchased for resale, a tax-paid purchases resold deduction is warranted on the cost of the excess.

### **FUEL USED IN DEMONSTRATORS** **0609.20**

Tax applies to all fuel used in the operation of motor vehicles. Amounts reported by dealers for personal or business use of demonstrators under the  $\frac{1}{40}$ th or  $\frac{1}{60}$ th formula pursuant to Regulation 1669.5 (Appendix 1) do not include the cost of fuel consumed in the vehicles while being used for such purposes.

## **SALES IN INTERSTATE AND FOREIGN COMMERCE**

**0610.00**

### **GENERAL**

**0610.05**

In verifying sales where delivery is claimed to have been made outside this State, it is usually necessary to review correspondence, factory delivery orders, acknowledgments, Department of Motor Vehicles Dealer Reports of Sale and other documents.

### **FACTORY DELIVERIES AT POINTS OUTSIDE THE STATE**

**0610.10**

Where a dealer in this State makes a sale to a consumer at a point outside this State, the dealer must retain in his files the necessary data and documents to prove that the car was not sold for use or storage in this State. A substantial number of such sales are factory deliveries. When such sales are made the California dealer requests the factory or dealer located in another state to deliver a car to:

- a) A consumer residing in this State, or
- b) A consumer residing in another State.

In (a), the California dealer must ordinarily collect use tax. This is particularly true in cases where the purchaser takes California license plates to be placed on the new car. The Motor Vehicle Code restricts the issuance of plates to those cars which ordinarily are to be used in California. Consequently, in the absence of evidence to the contrary, the fact that California plates were obtained will be regarded as proof that the car was purchased for use in this State. In (b), the California dealer should retain complete data concerning the transaction. Shipping or delivery orders and any other documents should be retained showing the purchaser's address, the point at which delivery was made, and indicating that the car was purchased for use outside of California.

### **INTERSTATE DELIVERIES FROM CALIFORNIA STOCKS**

**0610.15**

Claimed interstate sales from a dealer's California stock usually fall into one of the following categories:

- a) Delivery to a carrier for shipment out-of-state
- b) Delivery out-of-state by dealer's employee or agent
- c) Delivery in-state to an out-of-state purchaser
- d) Delivery in-state to the out-of-state purchaser's agent

Under (a), the sale is exempt if delivery is made to a carrier, consigned to an out-of-state point, and actually shipped to the out-of-state point. The dealer should retain a copy of the bill of lading to support the deduction. The auditor should ascertain who delivered the unit to the carrier, and that the vehicle was not in the possession of the purchaser or the purchaser's agent in this State at any time before the shipment.

Situations under (b) arise when a dealer is requested to make delivery in a neighboring state. *The transaction is not taxable if the car is actually delivered by an employee acting as agent of the dealer, or by some other individual acting as agent of the dealer.* The fact that the person delivering is in fact the agent of the dealer must be clearly established in each case. Affidavits, reimbursement by the dealer for expenses, or payment of a fee by the dealer are usually sufficient supporting evidence. *In the absence of evidence to the contrary, such a sale cannot be held exempt from tax if California license plates are secured for the delivered car.* The fact that the purchaser accompanied the dealer's agent or assisted in driving the vehicle to an out-of-state location does not negate the exemption. *See Section 0610.45 for information on sales to military personnel.*

Under (c) and (d) delivery to a consumer or his agent in this State is a taxable transaction regardless of the evidence that the car was driven or shipped out-of-state by the purchaser or his representative. Cars in this situation are usually driven out-of-state on one-trip permits or on plates of another state. The auditor must be alert to deliveries to the purchaser's agent where the dealer holds out that the person is the dealer's agent through affidavit or payment of expenses. The person cannot act in a dual capacity as agent of both buyer and seller.

## **BAILEE CLAUSE**

**0610.20**

The auditor may encounter sales by a dealer who has been instructed by his customer to ship or deliver a vehicle to a third person, usually a body builder within the State, as bailee. The customer's purchase order will include instructions not to charge sales tax as the vehicle is to be shipped out-of-state. A "Bailee Clause" may appear on the order.

The mere inclusion of a "Bailee Clause" on an order from a purchaser does not exempt the sale as a sale in interstate commerce. The auditor must determine, if the sale is to be exempt, that the shipment out-of-state by the bailee is done in accordance with instructions from the dealer and not the customer. *If the "bailee" is the customer's agent, an exempt sale has not been made.*

## **ONE-TRIP PERMITS**

**0610.25**

California dealers sell automobiles to non-residents as well as residents, (leasing companies, contractors, and retailers) who intend to register and use the vehicles in another state. The purchasers are allowed to transport their cars on their own wheels outside this State without obtaining California plates by securing a "one-trip permit" from the Department of Motor Vehicles.

Section 4003 (a) of the Vehicle Code provides that a one-trip permit "may be issued by the Department for operating a vehicle while being moved or operated unladen for one continuous trip from a place within this State to another place either within or without this State, or from a place without this State to a place within this State".

Section 4003 also allows the issuance of a quantity of these permits in booklet form upon payment of the proper fee for each permit contained in the booklet. Each permit shall be valid for only one vehicle and for only one continuous trip, and only after a copy describing the vehicle has been forwarded to the department. There is no restriction as to whom they are issued. Dealer can and do secure them in their own name however, in those instances where cars are driven from the dealer's place of business to a point outside this State, it will be presumed that title passed to and redelivery was taken by the purchaser in this State, for the reason that the dealer would ordinarily use his dealer's plates if he drove the unit across the State line. Dealers may overcome this presumption if they are able to furnish documentary evidence that pursuant to the contract of sale the car was delivered to the purchaser outside the State.

## **FOREIGN PURCHASERS**

**0610.30**

Sales of automobiles to foreign purchasers for shipment abroad and delivered to a ship furnished by the purchaser for the purpose of carrying the property abroad and actually carried to a foreign destination, title and control of the automobile passing to the foreign purchaser upon delivery, are exempt sales in foreign commerce.

Copies of import documents of a foreign country or other documentary evidence of export must be obtained and retained by the dealer to support the deduction.

The auditor should also ascertain by whom the automobile was delivered to the dock or ship, and also that the unit was not delivered to the foreign purchaser in the State, returned to the dealer and then delivered to the dock by the dealer.

*If delivery was made to the purchaser any time after the sale, or if the purchaser or his agent drove the automobile to the dock the sales tax applies.*

## **COMMON CARRIERS**

**0610.35**

In certain rare situations the purchase of vehicles may be exempt from use tax under Regulations 1620 and 1621. For example, where vehicles purchased by public carriers for use in interstate or foreign commerce in California are actually placed in use in interstate or foreign commerce prior to entry into this State and are thereafter used continuously in interstate or foreign commerce. Similarly, use tax does not apply where vehicles purchased for use in other states or foreign countries are shipped to this State and remain here temporarily pending reshipment to such other states or foreign countries and are actually used solely outside this State. If a vehicle purchased outside the State is assigned to interstate or intrastate use in this State, the question of whether it had been substantially used outside California before entry into this State (so that use tax would not apply) arises and must be fully examined and commented upon by field auditors for submission to headquarters.

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## **DELIVERY TO A CONSUMER IN CALIFORNIA FROM A POINT OUTSIDE THIS STATE**

**0610.40**

While it seldom happens that a dealer in this State causes a car to be delivered directly from the factory to a consumer in this State in interstate commerce, such transactions do occasionally occur, particularly with respect to special factory-built jobs, high-priced trucks, fire fighting vehicles, etc. Where the ordinary rules of interstate commerce have been observed and the contract of sale specifies that the unit shall be delivered in interstate commerce, the sale is subject to use tax, and the dealer is responsible for the collection and payment of the use tax to the State.

## **MILITARY PERSONNEL**

**0610.45**

Sales of vehicles in California to military personnel are subject to sales tax regardless of the serviceman's place of residence. The dealer must also collect use tax on the sale of vehicles outside this state to servicemen for use in this state, unless the sale is made prior to the effective date of his discharge, and his intention to use the vehicle in California results from official orders transferring him to California and not from his own independent determination. With respect to purchases made prior to January 1, 1977, the serviceman will be considered to have made his own independent determination to use the vehicle in California if he contracts to purchase the vehicle after he has received official orders transferring him to California. With respect to purchases made on and after January 1, 1977, the serviceman will be considered to have made his own independent determination to use the vehicle in California, without regard to the time of receipt of official orders transferring him to California, if at the time he contracts to purchase the vehicle he arranges to take receipt of the vehicle in California.

## **OVERSEAS DELIVERIES**

**0610.50**

Sales to military personnel and overseas government employees claimed in Interstate Commerce often present problems of documentation. The purchasers involved travel on government orders and are authorized shipping space for automobiles either to accompany them or to follow at a later date. The shipping involved is either a vessel operated by Military Sea Transport Service (MSTS) or a vessel under contract with MSTS. The purchaser or his agent will furnish the dealer with data for shipment and indicate the government facility to which the unit is to be delivered. All documentation prepared by the government indicates the purchaser as consignor and consignee. The documents consist of either a government bill of lading or automobile delivery receipt or both. Errors often arise in these documents by failure to show the party delivering to the government dock. More experienced dealers prepare their own delivery receipts and have the receiving authority sign for the vehicle. Auditors must be alert to vehicles accompanying the purchaser on the same vessel, since there is the tendency to give possession to the purchaser, and allow him to deliver the vehicle to the government facility himself.

## **FOREIGN GOVERNMENTS, CONSULS, AND CONSULATES**

**0610.60**

Sales tax generally applies to sales to foreign governments, including sales to consulates general, consular agencies, and other consular posts.

However, sales of vehicles by California dealers to foreign career consular officers, and certain career consular employees employed in the administrative or technical service of a consular post are not subject to the California sales tax if: 1) the country which the person represents is one covered by a treaty providing for an exemption from the California sales and use tax, 2) the purchaser is acting in a capacity which entitles him to an exemption, (service staff employees and honorary consular officers are not eligible for an exemption), 3) the purchaser is not a citizen of the United States or a resident alien, and 4) the purchaser is properly identified as to name and his official consular capacity.

The Board of Equalization will issue a press-numbered Sales and Use Tax Exemption Card, Form BT-469, for purposes of identification, to all consular officers, employees and members of their families who qualify for the exemption.

## **LABOR AND REPAIR OPERATIONS**

**0611.00**

### **GENERAL**

**0611.05**

The composition of Labor and Internal Sales deduction varies between dealers. Some dealers lump both type sales together as a single deduction, while others state them separately. In some cases the deduction is used as a catch-all for a combination of deductions. Due to the variations employed it is necessary to inspect the sales tax working papers to determine method and consistency in handling.

### **TESTS OF LABOR DEDUCTIONS**

**0611.10**

No inflexible rule can be established for testing repair orders. One inherent difficulty is that posting copies of repair orders are filed in numerical sequence while posting of detail to the daily sales summary is by date. Another problem occurs in larger shops when the floor-men are assigned books of blank orders from different numerical series. It is not uncommon, therefore, to have several series of numbers used on the same date, or to have one series of fifty numbers spanning a period of a month.

The volume of the service department, availability of repair orders, prior audit findings, and experience of the auditor all related to the time involved to make a test dictate the extent of test, if any, to be made.

### **BILLINGS BASED ON ESTIMATES**

**0611.15**

Some dealers will prepare estimates on larger repair jobs, and invariably prepare detailed estimates for insurance companies. Usually an itemized bid will show separately the price of labor, sublet labor, parts and tax reimbursement measured by the sales price of the parts. The bid may be given to either the customer (vehicle owner) or to the insurer.

Tangible personal property used in the actual repair work may differ from what was estimated when the bid was made. In such instances, some dealers enter the sales price of the property actually furnished in their books of account and report sales tax measured by that price.

An amount represented as the sales price of parts in an accepted bid is the taxable measure required to be reported by the repairman unless there is a subsequent modification of the bid agreement and the customer or the insurer is informed of the change, provided, however, that the sales price of the parts is not less than the cost of the parts actually used. The bid agreement may be modified by an invoice or a priced repair order given to the customer or the insurer showing the sales price of the property actually furnished by the repairman. If a bid is so modified and the customer or insurer is notified of the change, the amount represented as the sales price of the parts on the modified bid is the amount upon which tax must be reported.

When the accepted bid is in writing, the subsequent modification to the bid agreement must also be in writing. The customer or the insurer should be notified of such modification prior to completion of the sale (e.g., delivery of the repaired automobile).

### **SUBLET REPAIRS (OUTSIDE WORK)**

**0611.20**

The sublet repairs account is essentially made up of any repair work or servicing that cannot be performed at the dealer facilities. The charge of the outside repairman is debited to Sublet Repairs (Inventory Account), and the billing to the customer on the repair order is credited to Sublet Repairs. The extent of sublets will vary from dealer to dealer with the size of the service facilities being the governing factor. The larger dealers will have facilities for the majority of servicing operations and consequently sublet only specialized work. The problem of the dealer is the segregation of parts and labor on the billings from the sub-repairman, and the subsequent breakdown of the sale between parts and labor. A large portion of the sublet purchases are solely service or labor, e.g. body repair, painting, carwash.

Examination of the purchase journal and disbursements journal will disclose the sub-repairmen who perform the majority of outside work, and the subsequent examination of purchase invoices of those vendors will disclose the existence of parts billings and the manner in which the dealer recorded the parts. If necessary, the auditor should then examine the repair orders for the proper segregation of parts sales.

## **FABRICATION LABOR AND SPECIAL PAINTING**

**0611.25**

An unusual source of posting to a labor account is from the New Car or Truck Journal. These postings originate as the result of sales of new vehicles on which special work is performed. While dealers may consider the charges to be repair or installation labor, the charges are for fabrication labor on the sale of a finished product and thus taxable. The charge for labor is posted to a labor account and may be included in the labor deduction.

The charges most commonly made are for porcelainize, underseal, and special paint jobs. Examination of new car journals and scrutiny of posting references to the labor accounts normally will disclose the existence of these transactions. Less common are repair orders, prepared simultaneously with the new car invoice, on which charges for fabrication labor are made.

## **VEHICLE ENGINE EXCHANGES**

**0611.30**

It is common practice among motor vehicle dealers to exchange reconditioned engines for worn engines. "Engine" as used here includes an entire engine, a short block, and a short, short block:

- a) An entire vehicle engine has a head and pan, but does not necessarily have a fuel pump, carburetor, distributors, etc.
- b) A short block is an engine cylinder block without cylinder head or heads.
- c) A short, short block is an engine cylinder block without cylinder head or heads and without oil pan and oil pump.

The exchange of a reconditioned vehicle engine for a worn engine, together with the removal of the worn and installation of the reconditioned engine in a vehicle, constitutes an integral transaction, and tax applies to the total charge for making the exchange without deduction on account of charges for removal of the worn or installation of the reconditioned engine, or without addition on account of the value of the worn engine accepted in exchange provided, however, that if due to the defective condition of the worn engine, an additional amount is charged to the customer, tax applies to such additional charge.

If the dealer makes an accurate segregation of the charges for the labor of removing the old and installing the reconditioned engine, and bills such charges separately, he may compute his tax upon the amount separately charged for the reconditioned engine, provided such charge includes the fair retail value of the old engine removed from the customer's vehicle.

If the dealer replaces a worn engine with a new engine, the measure of tax is the full selling price of the new engine including the trade-in value of the old engine removed from the customer's vehicle and retained by the dealer.

If the dealer rebuilds (overhauls) the customer's own engine, the transaction is treated as a regular repair job.

Some dealers also exchange engines where no installation by the dealer is involved. The measure of tax when a new engine is sold "over-the-counter" must include the trade-in value of the old engine taken in exchange. If the dealer makes an "over-the-counter" exchange of a reconditioned engine, the transaction is governed by paragraph (b)(4) of Regulation 1546 and the measure of tax is the exchange price.

## **USED AND RECONDITIONED PARTS**

**0611.35**

When a used part is sold and a trade-in is involved, the tax is due on the full sales price of the used part including the value of the trade-in.

When a reconditioned part is sold, tax applies to the amount charged by the repairman or reconditioner for the reconditioned property.



## **LUMP SUM REPAIRS**

**0611.40**

The Business and Professions Code requires automobile repairers to prepare detailed estimates and invoices for their customers on all repair jobs except minor repairs of the type customarily performed by gasoline service stations. Sections 9884.8 and 9884.9 of this Code provides:

- 9884.8 All work done by an automotive repair dealer, including all warranty work, shall be recorded on an invoice and shall describe all service work done and parts supplied. Service work and parts shall be listed separately on the invoice, which shall also state separately the subtotal prices for service work and for parts, not including sales tax, and shall state separately the sales tax, if any, applicable to each. If any used, rebuilt, or reconditioned parts are supplied, the invoice shall clearly state that fact. If a part of a component system is composed of new and used, rebuilt or reconditioned parts, such invoice shall clearly state that fact. One copy shall be given to the customer and one copy shall be retained by the automotive repair dealer.
- 9884.9(a) The automotive repair dealer shall give to the customer a written estimated price for labor and parts necessary for a specific job. No work shall be done and no charges shall accrue before authorization to proceed is obtained from the customer. No charge shall be made for work done or parts supplied in excess of the estimated price without the oral or written consent of the customer which shall be obtained at some time after it is determined that the estimated price is insufficient and before the work not estimated is done or the parts not estimated are supplied. Nothing in this section shall be construed as requiring an automotive repair dealer to give a written estimated price if the dealer does not agree to perform the requested repair.
- (b) The automotive repair dealer shall include with the written estimated price a statement of any automotive repair service which, if required to be done, will be done by someone other than the dealer or his employees. No service shall be done by other than the dealer or his employees without the consent of the customer, unless the customer cannot reasonably be notified. The dealer shall be responsible, in any case, for any such service in the same manner as if he or his employees had done the service.

The Department of Consumer Affairs, Bureau of Automotive Repair, licenses automotive repairers and administers these sections of the Code.

Most dealers comply fully with these provisions and have devised work orders which serve as both a written estimate and an itemized invoice.

Some dealers may advertise a set charge for certain major repair jobs, with the price inclusive of tax. The segregation of charges on such jobs is usually based on an experience factor. The amount of parts sales reflected by the posting segregation must be at the fair retail value. In those cases where tax reimbursement is shown on the invoice, the taxable measure will be in accordance with Regulation 1700, Reimbursement for Sales Tax, unless the measure so computed is less than the fair retail price of the parts.

## **CREDIT TO EXPENSE ACCOUNTS**

**0611.45**

Credits to expense accounts for sales recorded in the sales journal are discussed in Section **0604.40**. In some instances, credits are found in the Parts, Accessories, and Service Journal. The amount charged on individual repair orders is small and the total amount per month is not substantial. These are estimated amounts for nuts, bolts, washers, etc., which because of negligible unit costs, are not controlled in the cost system.

Examination of the general ledger accounts and Service Journal will disclose the accounts involved and examination of repair orders will determine if tax reimbursement was effected.

## **MODIFICATIONS TO VEHICLES USED BY PHYSICALLY HANDICAPPED PERSONS**

**0611.50**

Beginning January 1, 1979, tax does not apply to the sale, storage, use or other consumption, in California of materials used to modify a vehicle for a physically handicapped person, regardless of whether the property is installed by the retailer or another person.



## **BAD DEBTS AND REPOSSESSION LOSSES**

**0612.00**

Deductions for accounts found to be worthless and for losses resulting from repossessions are proper if there has been compliance with the requirements of sales tax Regulation 1641, Credit Sales and Repossessions and Regulation 1642, Bad Debts.

Bad debts charged off for income tax purposes, or if the retailer is not required to file income tax returns charged off in accordance with generally accepted accounting principles, usually will be greater than amounts allowable as a deduction for sales tax purposes. They will include labor, sales tax, cartage, resales, interstate sales, etc.

If the taxpayer has not claimed repossession losses, or has claimed the entire book loss, he should be asked to schedule each loss in accordance with Regulation 1642. Where the repossessions are voluminous, or the back-up data is not readily available, the deduction may be computed on a test basis, and the results of the test applied to recorded amounts. The dealer should be required to compile the test data. The deduction should not be computed by applying a percentage which is estimated, unsupported, or based on audits of other dealers.

The auditor should verify that recoveries of bad debts previously claimed or allowed by the auditor are included in the reported taxable measure.

Amounts received from collection agencies will not include the total recoveries. The amount retained by the collection agency should be added to the recorded recoveries, as it is an expense of collection and not exempt from tax.

## **USED CAR DEALERS**

**0614.00**

### **GENERAL**

**0614.05**

The majority of the subject matter in the preceding sections pertains to new car dealer's operations. While the new car dealer will have a used car department, and that operation is confined to used car sales, the accounting procedures and controls inherent in the cost accounting system cause the new car dealer's operation to be considerably different from an auditing standpoint. Many of the sections already discussed will apply in their entirety to a used car dealer's operations.

### **USED CAR DEALER'S RECORDS**

**0614.10**

Although many used car dealers will employ a double entry system and exert excellent control of purchases inventories and expenses, some use a single entry system with varying degrees of control.

A common means of control in used car dealer's records are car envelopes and inventory books. In all instances the certificated used car dealer will be issued Dealer's Report of Sale Books by Department of Motor Vehicles.

Those dealers selling late model used cars will in most cases have flooring loans on purchases and sell on conditional sales contracts with recourse.

### **CAR ENVELOPES**

**0614.15**

The majority of used car dealers will utilize car envelopes rather than the customer folders used by new car dealers. Cars purchased are normally assigned an inventory number with a car envelope prepared for the unit. Details of purchase and sale are placed on the appropriate lines on the printed face of the envelope and all documents of purchase, reconditioning and sale are inserted in the envelope.

Car envelopes are sometimes the only records maintained or available and reportings for sales tax are based on tapes prepared from car envelope data. In such cases the auditor's verification should consist of the sequence and completeness of inventory numbering, a test of contents of the car envelopes, reconciliation with Department of Motor Vehicles Dealer's Reports of Sale and correctness of reportings.

### **INVENTORY BOOKS**

**0614.20**

Some dealers will record all purchases in an inventory book and employ this book as a combination purchase and sales journal. Detail of source of purchase, date, description and cost are entered reflecting the purchase. The date of sale, name of customer, and selling price are recorded at time of sale.

The lag in time that exists on some sales is a major difficulty in this type of accounting. The dealer may omit sales of units purchased in quarters prior to the period of sale. Dealers' Reports of Sale should be tested extensively in these audits to determine completeness of sales records.

### **DEALER'S REPORTS OF SALE**

**0614.25**

The only record common to all used car dealers is the Report of Sale Book. Use of the books to determine the completeness of the recorded sales is standard procedure. The extent of examination of reports of sales is dependent on size of operation, class of merchandise, and type of formal records maintained.

It should be noted that preparation of report of sale requires the remittance of license or transfer fee. The remittance is usually made along with Form 247, which contains information regarding report of sale number, or license number, and amount of license or fees remitted. If the auditor suspects that all books have not been made available, an examination of the duplicate copies of Form 247 retained by the dealer is a ready source for comparison.

### **FLOORING AND FINANCE COMPANY RECORDS**

**0614.30**

Dealers who sell late-model used cars often enter into flooring loans on purchases. In audits of dealers with sparse records, or if the auditor suspects that incomplete data have been furnished, examination of flooring contracts or financing-agreements in the hands of the dealer or located at the lending institution is a means of verification.

## **KELLEY BLUE BOOKS**

**0614.35**

Often the auditor will establish unrecorded sales through audit procedures discussed in the above sections, with establishment of reasonable selling prices the only unresolved factor. The most common reference guide is the Kelley Blue Book, and use of the suggested selling prices therein eliminates arbitrary or unfounded prices.

## **USED CAR WHOLESALERS**

**0614.40**

One type of used car operation that is unique is that of the used car wholesalers. They are usually located in the metropolitan areas and sell to dealers within a radius of 200–300 miles. The majority of their sales are to used car dealers, but some retail sales are made. The sources of purchase vary but the bulk of cars are procured from large dealers, leasing companies, fleet users, and out-of-state wholesalers. The operation is based on quick turnover at small margin of profit (\$25 – \$50 per unit). While this type of operation usually requires detailed records, volume alone is the cause of errors. Since retail sales are usually few in number, by comparison with total units sold, it is desirable to trace all sales per Dealer Report of Sale Books to the recorded taxable. The most common sources of errors, however, are the lack of supporting resale certificates, and incomplete wholesale car orders which incorporate the resale certificate. A detailed examination of claimed resales with special emphasis on “one-shot” sales is often in order.

## TRUCK MANUFACTURERS

**0615.00**

Several major truck manufacturers maintain factory branches within the State. These act as both distributors and dealers. Their records do not conform with any of those described in the preceding sections, nor do their methods of reporting sales tax liability follow any set pattern.

Sales made by the branch, other in-state branches, out-of-state branches, the home office, and factory will be subject to sales tax in some cases and to use tax in other cases.

The auditor should familiarize himself with the entity as to locations of factories, divisions, home office and permits. He should also review the sales tax working papers in detail for inclusion of sales by other than the local branch. Discussion with branch manager, sales manager and other key personnel will give the auditor a better understanding of the audit problems he will have to solve. It is very possible that the audit will be or should be controlled by the Out-of-State District. As soon as it is determined that work is to be done out-of-state, the Out-of-State District should be notified. The auditor, in addition to covering the audit of recorded and/or reported liability, should review correspondence files, inter-branch and home office accounts and statements, internal billings and warranty charges to home office.

Audits of truck manufacturers should be quite detailed, since no one reporting period will prove typical of the operations of the retailer for the audit period.

The auditor should also be alert to the leasing operations of truck manufacturers. Leases should be carefully examined to determine the status of truck tractors, trailers, trucks, and dollies. (See Section **0620.15.**)

## MISCELLANEOUS

0616.00

### CLEAN DEALS TEST

0616.25

Reference has been made to dealers who fail to submit Dealer's Reports of Sale. It is often difficult to detect such practice but there are several ways in which this can be done depending upon the exact circumstances. The so-called "clean deals" test may be employed. This test simply consists of determining the percentage of clean deals (i.e., cases in which a purchaser buys a new car without trading in an old one) compared with the total car sales.

### FORM BT-543, CLEAN DEAL QUESTIONNAIRE

0616.30

Form BT-543, is a questionnaire directed to the purchaser of a vehicle. *Form BT-543 should be used with discretion and only in those instances where an audit supervisor feels that information obtained directly from motor vehicle purchasers might be of substantial value in ascertaining whether either a dealer or a salesman has incurred unreported tax liability.* The letter is to be directed to selected purchasers and should, wherever possible, show a description of the car. It should be mailed with an addressed and stamped envelope and should bear the dealer's permit number (not name) for identification purposes. Only one copy need be prepared since a control record can be maintained by appropriate notations on working paper schedules. (See Exhibits B and C).

## SALES TAX REGULATIONS PERTAINING TO AUTOMOBILE DEALERS

0616.40

- 1546 — Installation, Repairing and Reconditioning in General
- 1547 — Vehicle Engine Exchanges
- 1548 — Tire Retreading and Recapping
- 1551 — Repainting and Refinishing
- 1553 — Miscellaneous Repair Operations
- 1566 — Automobile Dealers and Salesmen
- 1569 — Lienor and Consignees of Tangible Personal Property for Sale
- 1610 — Vehicles, Vessels and Aircraft
- 1620 — Interstate and Foreign Commerce Generally
- 1628 — Transportation Charges
- 1641 — Credit Sales and Repossessions
- 1642 — Bad Debts
- 1654 — Barter, Exchange, "Trade-Ins"
- 1655 — Returns, Defects and Replacements
- 1660 — Leases of Tangible Personal Property — In General
- 1661 — Leases of Mobile Transportation Equipment
- 1669 — Demonstration, Display, and Use of Property Held for Resale — General
- 1669.5 — Demonstration, Display, and Use of Property Held for Resale — Vehicles
- 1684 — Collection of Use Tax by Retailers
- 1685 — Payment of Tax by Purchasers
- 1700 — Reimbursement for Sales Tax

### SUGGESTED AUDIT PROGRAM — NEW CAR DEALER

0616.45

Exhibit A outlines a suggested audit program for use in auditing new car dealers. It should be of considerable aid in setting up and following an audit program of the typical new car dealer. Parts of it may be adapted for audits of used car dealers.

### EXAMINATION OF FACTORY WARRANTY ACCOUNTS

0616.50

California residents sometimes purchase automobiles from car dealers in neighboring states such as Oregon, Nevada and Arizona. They then license the vehicles out-of-state and return them for use in California without payment of the use tax. Auditors should examine factory warranty accounts of California dealers performing the warranty service on these vehicles as a means of securing information for use tax purposes.

## **LEASING**

**0617.00**

### **GENERAL**

**0617.05**

One of the principal factors in determining the application of tax to leases is the type of vehicles involved. A distinction must be made between passenger cars and vehicles defined in the law as "mobile transportation equipment". Both types of vehicles are defined in the following sections. Regulations 1660 and 1661 cover the application of the tax to leases.

### **DEFINITIONS — VEHICLES OTHER THAN MOBILE TRANSPORTATION EQUIPMENT**

**0617.10**

The following vehicles are not mobile transportation equipment and are treated in the same manner as passenger cars for tax reporting purposes:

- a) Passenger Vehicles  
Section 465 of the California Vehicle Code provides that a passenger vehicle is any motor vehicle, other than a motor truck or truck tractor, designed for carrying not more than 10 persons including the driver, and used or maintained for the transportation of persons, except that effective 1-1-77, any motor vehicle other than a motor truck or truck tractor, designed for carrying not more than 12 persons, including the driver, which is maintained and used in the nonprofit transportation of adults to and from a work location as part of a carpool program or when transporting only members of the household of the owner thereof shall be considered to be a passenger vehicle for the purposes of this section.
- b) House cars and motor homes.
- c) Motorcycles.
- d) A combination pickup and camper leased as a unit and registered with the Department of Motor Vehicles as a house car. If such vehicles are not registered as house cars they are regarded as mobile transportation equipment.
- e) Mini-buses are vans designed primarily for carrying persons, and limited in design to carrying not more than 10 persons including the driver. For exception, see Paragraph (a) above.
- f) Forklift trucks.
- g) Trailers and baggage containers designed for hauling by passenger vehicles.
- h) One-Way Rental Trucks

These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, with a manufacturer's gross vehicle weight rating not exceeding 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition, or upon being employed in this state by the person are identified to the Board as one-way rental trucks by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased, and by maintaining records which can be verified by audit of the vehicles as to which such an election has been made.

Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and shall make known to the customer any taxes which are payable measured by the rentals. Once a truck is identified to the Board as a one-way rental truck, the election may not be revoked with respect to that truck. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.

The lease or rental of a vehicle not classified as mobile transportation equipment is a continuing sale during any period of time in which the vehicle is in this state unless tax or tax reimbursement has been paid timely measured by the purchase price of the vehicle and it is leased or rented in substantially the same form as acquired. If tax or tax reimbursement has not been so paid, and the lessor desires to pay tax measured by the purchase price, it must be reported and paid with the tax return for the period during which the property is first placed in rental service.

Leases or rentals which are continuing sales are subject to tax measured by the rental charges. Generally, the applicable tax is a use tax imposed upon the lessee which must be collected and paid to the state by the lessor when he collects the rental charges. When the lessee is not subject to use tax (e.g., insurance companies, the United States or its instrumentalities), the sales tax applies. The sales tax is upon the lessor and is measured by rentals payable. Leases to the United States or its instrumentalities became subject to sales tax effective January 1, 1979. For periods prior to January 1, 1979, neither the sales tax nor the use tax applied if the lessee was the United States Government or one of its agencies or instrumentalities, unless federal law permitted the lessee to be taxed. Consequently, sales tax applies, before and after January 1, 1979, to leases to such organizations as national banks and federal savings and loan associations, which are permitted by federal law to be taxed; however, leases to such organizations as federal reserve banks, federal credit unions, and federal land banks, which are not so permitted, are exempt from tax prior to January 1, 1979, but subject to sales tax afterwards.

The timely payment of tax or tax reimbursement measured by the purchase price of the vehicle constitutes an irrevocable election not to pay tax measured by rental receipts. This election may not be changed by reporting tax on rental receipts and claiming a tax paid purchase resold deduction for the tax paid on the purchase price. When tax or tax reimbursement has been paid timely measured by the purchase price of the vehicle the lessor may not collect an amount from the lessee designated as tax or tax reimbursement.

For periods prior to January 1, 1979, any amount so collected constitutes excess tax reimbursement and should be refunded to the lessee. If it is not refunded or credited to the lessee, it must be paid to the state.

For periods on and after January 1, 1979, those amounts so collected by a lessor who is a retailer, which are designated as the tax must be refunded to the lessee or paid to the state per Section 6204 of the law.

## **DEFINITIONS — MOBILE TRANSPORTATION EQUIPMENT**

**0617.15**

The following vehicles are classified as mobile transportation equipment:

- a) Trucks
- b) Buses
- c) Truck Tractors
- d) Truck Trailers
- e) Pickup trucks, including such vehicles as El Caminos, Rancheros, Datsun, and Toyota pickups, etc. Even though pickup trucks are often thought of as passenger vehicles, they are in fact mobile transportation equipment and must be treated as such for tax purposes.
- f) Vehicles designed for carrying more than 10 persons, including the driver, are regarded as mobile transportation equipment and not passenger vehicles, except that effective 1-1-77, any motor vehicle other than a motor truck or truck tractor, designed for carrying not more than 12 persons, including the driver, which is maintained and used in the nonprofit transportation of adults to and from a work location as part of a carpool program or when transporting only members of the household of the owner thereof shall be considered to be a passenger vehicle.
- g) Panel trucks designed primarily for carrying property. Also, van equipped with a seat in the front only designed primarily for carrying property.
- h) Hearses
- i) Tangible personal property which is or becomes a component of mobile transportation equipment.
- j) Bogies

The term "bogie" means a vehicle consisting of an axle or axles with wheels and tires and a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed to allow a sliding movement under a container (or van body) to several positions in order to adjust to the desired axle loading.



k) Chassis

The term “chassis” means a frame with one or more axles designed to be used in conjunction with, and as a temporary support or undercarriage, for a container or other van-type box. The chassis and axle, or axles, may be designed and constructed to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.

l) Dollies

The term “dolly” means a vehicle consisting of a tongue, fifth wheel, and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.

When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a “full” trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle, or axles, equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.

Prior to January 1, 1980, lessors and lessor dealers of mobile transportation equipment who purchase the equipment with the intention of leasing it are the consumers of such equipment which they lease or rent to others. Generally, they are required to pay tax measured by the purchase price of such equipment and cannot issue a resale certificate for the mobile transportation equipment. Beginning January 1, 1980, both dealer and non-dealer lessors of mobile transportation equipment who cannot otherwise properly issue a resale certificate may issue such a certificate for the limited purpose of reporting their use tax liability based on fair rental value. This election must be made on or before the due date of the return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on a timely return for that period. Tax must thereafter be paid with the return for each reporting period, and measured by the fair rental value whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made. Fair rental value is normally regarded as the amount received from the lessee.

A lessor of mobile transportation equipment should not collect an amount designated as tax or tax reimbursement from the lessee. This is true whether tax was paid on the purchase price of the equipment or the lessor elected to measure his use tax liability by fair rental value. Any tax so collected constitutes excess tax reimbursement and should be refunded to the lessee. For periods prior to January 1, 1979, if it is not refunded or credited to the lessee, it must be paid to the state. On and after January 1, 1979, amounts, which represent reimbursement for tax paid on the purchase price of the equipment, collected as “use tax” by a lessor who is a retailer must be refunded to the lessee or paid to the state per Section 6204 of the law. However, effective January 1, 1979, when a lessor of mobile transportation equipment elects to pay his use tax liability based on fair rental value, the lessor may separately state a charge to his lessee designated as use tax.

Beginning July 1, 1979, any separately stated amount collected from a lessee by a lessor electing to report use tax measured by fair rental value under the representation by the lessor that the amount is use tax imposed on the customer must be returned to the customer or paid to the board. A designation by the lessor of a separately stated amount as “use tax”, without further explanation, will be regarded as a representation that the amount is use tax imposed on the customer.

## **SPECIAL FACTORS WHEN TAX REPORTED ON RENTALS**

**0617.20**

When tax liability is based on rental receipts, the following points must be considered whether the property leased is mobile transportation equipment or a passenger vehicle.

- a) **Registration of Vehicle**  
Leased vehicles must be registered as prescribed by Section 4453.5 of the California Vehicle Code in the name of either the lessor or the lessor/lessee jointly. If vehicles are registered in the name of the lessee only, tax liability may not be measured by rental receipts, and the transaction will be regarded as a retail sale subject to tax. (See Section 0607.15).
- b) **License Fees**  
The license fees paid to the DMV and included in a monthly lump sum charge made to lessees may be excluded from the rental charges subject to tax.
- c) **Late Charges**  
Additional charges made by the lessor as a penalty for overdue rental payments are not a part of rental receipts subject to tax if they are reasonable charges for the cost of money or additional administrative expense.
- d) **Interest Payments**  
Amounts designated by the lessor as interest, which the lessee must periodically pay along with amounts designated as rentals are part of rental receipts subject to tax.
- e) **Deficiency Charges**  
Any deficiency amount the lessee is required to pay at the termination of a lease to satisfy the base rental must be included in rental receipts subject to tax. If the lessee is given credit for any amount paid in excess of the base rental such credit may be excluded from rental receipts subject to tax.
- f) **Insurance Charges**  
Charges to the lessee for automobile insurance must be included in the rental charges subject to tax if the lessee is required to purchase the insurance from the lessor. However, if the lessee has an option to purchase the insurance from the lessor or an insurer of his own choice, the charges for the insurance, if separately stated, may be excluded from the rental charges subject to tax.
- g) **Gasoline Furnished by the Lessor (Wet Rentals)**  
A "wet rental" is a lease of a vehicle in which the total rental charge includes gasoline furnished by the lessor. Whether the sale of the gasoline to the lessor is subject to sales or use tax depends on whether the lessor is the retailer or the consumer of the gasoline furnished.  
  
When the lease of a vehicle is a continuing sale under the California Sales and Use Tax Law, the lessor is the retailer of gasoline furnished under wet rentals of the vehicles. Such gasoline may be purchased ex tax under a resale certificate, and if sales or use tax is reported and paid on the total rental receipts no additional tax liability accrues.  
  
When the lease of a vehicle is not a continuing sale because tax has been paid on the part of the vehicle, or because the vehicle is mobile transportation equipment, the lessor is the consumer of gasoline furnished under a wet rental, and tax applies to the sale of the gasoline to the lessor. However, if the lessor makes a separate charge to the lessee for the gasoline, the lessor is the retailer of such gasoline and the retail sale of the gasoline is subject to sales tax. In that case the lessor may purchase the gasoline ex tax under a resale certificate. In the case of a wet rental of mobile transportation equipment, where the lessor has properly elected to report his use tax liability measured by fair rental value, the use tax applies only to that portion of the rental charge attributable to the lease of the equipment.

## **TRUCKS AND TRAILERS SOLD BY OUT-OF-STATE AND IN- STATE RETAILERS**

**0620.00**

### **TRUCKS AND TRAILERS SOLD BY OUT-OF-STATE RETAILERS**

**0620.05**

The sale of a new or remanufactured truck, truck tractor, trailer, or semi-trailer, any of which has an unladen weight of 6,000 pounds or more, new or remanufactured trailer coach, or new or remanufactured auxiliary dolly to the purchaser in California is exempt from sales and use tax when the vehicle is delivered to the purchaser in California by the manufacturer or remanufacturer pursuant to a retail sale by an out-of-state dealer and certain conditions provided by Section 6388 of the Revenue and Taxation Code are present. For the sale of the property to qualify under this exemption, the manufacturer or remanufacturer must secure from the purchaser and retain:

- Written evidence that the purchaser has registered the vehicle out-of-state.
- The purchaser's affidavit attesting that he or she is not a resident of California and that he or she purchased the vehicle from a dealer who is located outside California for use outside the state.
- The purchaser's affidavit that the vehicle was moved or driven to a point outside this state within 30 days of the date of delivery of the vehicle to the purchaser.

Note: Effective January 1, 1984, the exemption was extended to include remanufactured vehicles.

### **TRAILERS SOLD FOR USE OUT OF-STATE, OR IN INTERSTATE OR FOREIGN COMMERCE**

**0620.10**

Section 6388.5 of the Revenue and Taxation Code also exempts from sales and use tax a sale of a new or remanufactured trailer or semi-trailer which has an unladen weight of 6,000 pounds or more when the vehicle is for use exclusively outside California or exclusively in interstate or foreign commerce or both and is delivered to a purchaser in California by an out-of-state or California manufacturer, remanufacturer or dealer pursuant to a sale by an out-of-state or California dealer and certain other qualifying conditions provided by Section 6388.5 of the Revenue and Taxation Code are met.

To substantiate the Section 6388.5 exemption, the dealer, manufacturer, or remanufacturer making the sale must secure from the purchaser and retain:

- Written evidence of an out-of-state license and registration for the vehicle.
- The purchaser's affidavit attesting that the vehicle was purchased from a dealer at a specified location either in California or outside California for use exclusively outside this state, or for use exclusively in interstate or foreign commerce.
- The purchaser's affidavit that the vehicle was moved or driven to a point outside this state either within: (1) 30 days from the date of delivery of the vehicle to the purchaser in California if it was manufactured or remanufactured out-of-state, or (2) 75 days from the date of delivery providing the vehicle was manufactured or remanufactured in California.

Notes:

- 1) Effective July 1, 1982, this exemption was extended to sales of trailers or semitrailers by dealers who are independent of the manufacturer. Also, the allowable qualifying time period for trailers and semi-trailers manufactured in California was extended from 30 days to 75 days.
- 2) Effective September 21, 1982, the exemption was extended to trailers and semitrailers purchased for use in foreign commerce.
- 3) Effective January 1, 1984, exceptions were extended to remanufactured vehicles.

## **TRUCKS AND TRAILERS SOLD TO LESSORS OF MOBILE TRANSPORTATION EQUIPMENT**

**0620.15**

All leases of trucks and truck type trailers (excluding “one-way rental trucks” as defined in Section 6024) are exempt from sales or use tax as leases of mobile transportation equipment.

Prior to January 1, 1980, lessors of mobile transportation equipment who purchase the equipment with the intention of leasing it are the consumers of such equipment which they lease or rent to others. Generally, they are required to pay tax measured by the purchase price of such equipment and cannot issue a resale certificate for the mobile transportation equipment. Beginning January 1, 1980, both dealer and non-dealer lessors of mobile transportation equipment who cannot otherwise properly issue a resale certificate may issue such a certificate for the limited purpose of reporting their use tax liability based on fair rental value.

## CHAPTER 6

### Exhibits

Suggested Audit Program — New Car Dealer .....	Exhibit A
Clean Deal Questionnaire — BT-543 Front .....	Exhibit B
Clean Deal Questionnaire — BT-543 back .....	Exhibit C

# SUGGESTED AUDIT PROGRAM — NEW CAR DEALER

## CHAPTER 6 EXHIBIT A

Records		Purpose	Scope of Examination
Initial Examination	Sales Tax Work Papers	Method of Reporting and Consistency	Audit Period
	General Ledger	Account Procedures	Audit Period
	Financial Statements	Unusual Postings	Audit Period
	Sales Tax Accrual Account	Comparison with STWP to Establish Base of Audited Amounts	Audit Period
Total Sales		Indications of Consistent Overaccruals or Substantial Amount in Specific Periods	Initial Reconciliation at Inception of Audit. Adjust Findings as Differences are explained or upon Findings that Accruals were not made.
	Sales Journals & General Journal	Examination of Content Credit	Audit Period
	Customer Folders	Postings to Other than Sales Accounts	Audit Period
	Car Invoices (Posting Copies)	Agreement of Documents Contents with Folders	Variable
Self Consumed & Use Tax	New Car Purchase Journal	Agreement with Records	Variable
	Cash Receipts Journal	Dealer Transfers and Courtesy Deliveries	Audit Period
	DMV Reports of Sale	Additional Sales	Audit Period
	Fixed Asset Accounts	Additional Sales	Variable
Sale for Resale	Company Car — Demonstrator Account	Sales of Fixed Assets	Audit Period
	Fixed Asset Accounts	Indication of Demonstrators, Company Cars	Audit Period
	Internal Journal	Self Consumption	Audit Period
	Purchase Invoices	Self Consumption on Company Cars	Variable
U.S. Gov't & Interstates	New Car Sales Journals & DMV Books	Self Consumed and Use Tax Purchases	Variable
	Use Car Journal	Sales to Leasing Companies and Registration Date	Audit Period
	Counter Invoices & Parts & Accessory Journal	Valid Resales	Audit Period
	STWP — Customer Folders	Validity of Resales & Composition of Postings	Variable
Motor Vehicle Fuel	Car Journals	Composition of Deduction & Supporting Documents	Audit Periods
	Sales Journals	Validity of Deduction	Variable
	Service Journal	Composition	Variable
	Repair Orders	Validity of Claimed Labor	Variable
Labor Sales	Purchase Invoices	Composition of Sublet	Variable
	Insurance Estimates	Differences between Repair Orders and Estimates	Variable
	Sales Tax Work Papers — Repo Loss Schedule	Accuracy of Deduction	Variable
	Cash Receipts or Collection Agency Statements	Recoveries on Bad Debts	Variable
Bad Debts — Repossession	Exemption Certificates	Validity of Deduction	Audit Period

STATE OF CALIFORNIA



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IN REPLY REFER TO:

Pursuant to provisions of the Sales and Use Tax Law, this Board presently is making an audit to verify tax returns filed by a retailer. The questionnaire on the reverse side of this letter requests confirmation of data relating to one or more transactions included in the scope of this examination.

Your cooperation in completing the questionnaire and returning it in the enclosed envelope as promptly as possible will be very much appreciated.

Very truly yours,

DISTRICT ADMINISTRATOR

By

Supervising Auditor

Enc.



# CLEAN DEAL QUESTIONNAIRE — BT-543 BACK

## CHAPTER 6 EXHIBIT C

Description of motor vehicle purchased:

_____	_____	_____	_____	_____
Make	Model	Year	Engine No.	License No.

I purchased the above motor vehicle:

From \_\_\_\_\_  
(Name)

\_\_\_\_\_  
(Address)

I dealt with: \_\_\_\_\_  
(Name of person with whom purchase was negotiated) ①

The seller was:                      A dealer                      A private party                      (check one)

Approximate date of purchase:                      \$ \_\_\_\_\_

Total price before trade-in (if any):                      \$ \_\_\_\_\_

Payment by:                      Cash down                      \$ \_\_\_\_\_

   Trade-in allowance                      \$ \_\_\_\_\_

   Conditional sales contract                      \$ \_\_\_\_\_

   Assumption of pre-existing contract ②                      \$ \_\_\_\_\_

Description of trade-in (if any):

_____	_____	_____	_____	_____
Make	Model	Year	Engine No.	License No.

Other information: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Signed \_\_\_\_\_  
(Your Signature)

Dated \_\_\_\_\_

Note ①                      If the seller was a private party, please state how you became aware that the vehicle was for sale and whether a dealer assisted in any way in the sale arrangements.

Note ②                      If you sold or transferred your equity in the motor vehicle you formerly owned to anyone other than a dealer named above, please explain fully.